FINANCIAL TIMES

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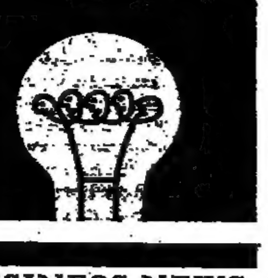

WORLD NEWS

German consumer price inflation falls to almost zero

German consumer price inflation sank almost to zero in January, providing more fuel for the argument over whether the European Central Bank should cut interest rates. German finance minister Oskar Lafontaine warned that the euro-zone may slip into deflation unless the ECB cuts rates. **Europe, Page 2**

Portugal offer on East Timor
Portugal has offered to fund the annual budget of East Timor, estimated at more than $100m, as its former colony decides on autonomy or full independence from Indonesia. **Asia, Page 6**

BoJ rejects economic boost
The Bank of Japan's policy board decided to leave monetary policy unchanged in an apparent rejection of calls for radical action to boost the faltering economy. **Asia, Page 6**

Art sales levy plan delayed
Germany backed away from confrontation with the UK over proposals to impose a harmonised levy on art sales in the European Union. **Europe, Page 2**

Japan's military stance reviewed
Japan's ruling Liberal Democratic party may decide to allow pre-emptive measures if Japan faced a threat of military action by another country. **Asia, Page 6**

Iran seeks backing for reforms
The Iranian government is seeking support from women voters and some 15m young Iranians to win their strong endorsement of its reformist policies in today's local elections. **International, Page 7**

'Supervision' for China's budget
China's National People's Congress set up a sub-committee to "supervise" the country's draft budget before it is adopted at the annual full session of the NPC. **Asia, Page 6**

Belarus regrets losing missiles
Belarus president Alexander Lukashenko said his country made a big mistake when it gave up Soviet nuclear missiles. **Europe, Page 2**

Money launderer gets 14 years' jail
A businessman who used a bureau de change as a front for Europe's biggest money laundering operation was jailed for 14 years in London. **Britain, Page 8**

BUSINESS NEWS

Airbus suffers 1998 operating loss of $200m

Airbus Industrie, the European civil aircraft consortium, made an operating loss of about £125m ($200m) last year because of a price war with Boeing of the US. The loss was revealed by British Aerospace, which has a 20 per cent stake in Airbus. **Page 21; Lex, Page 20; BAe's veil of secrecy, Page 28**

LVMH, the French luxury goods group, has stepped up its battle to control Gucci by asking a Dutch court to freeze voting rights on a huge block of shares issued by Gucci's board. **European companies, Page 23**

Morgan Stanley, the US investment bank, and N.M Rothschild of the UK have been appointed as advisers by the Italian Treasury to aid the sale of its stake in Telecom Italia. **European companies, Page 23; Editorial Comment, Page 19**

Profits at its mobile phones arm helped Telefónica offset the impact of deregulation in its fixed-line business in Spain and provisioning for Latin America. **European companies, Page 23**

Investors sold US Treasuries for the third day running on renewed fears that the Federal Reserve's next move will be to raise short-term interest rates. **Page 21; Bonds, Page 34**

Kirch Group, the privately-owned German media group, is close to taking control of the pay television venture Premiere. **International companies, Page 24**

The extent of corporate Japan's malaise was underlined when companies in a range of sectors issued profits warnings. **Asia-Pacific companies, Page 22**

DaimlerChrysler announced a 29 per cent rise in full year net profit. **European companies, Page 23; Lex, Page 20**

Dresdner Bank of Germany revealed that it had substantially increased loan loss provisions in the last quarter of 1998. **Page 21**

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Now it's time for the real test
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Brussels makes big farm reform concession

Move aimed at breaking logjam holding up radical changes in aid

By Michael Smith in Brussels

The European Commission yesterday made its first big concessions on farm reform in an attempt to break the logjam holding up the most radical change to the European Union's agricultural aid regime for 37 years.

The moves came as EU heads of government gathered in Petersberg, near Bonn, for an informal summit today to review the progress of talks on reforming the union's budget.

Germany, holder of the EU's rotating presidency, is under pressure to demonstrate progress on the "Agenda 2000" reform package – aimed at allowing the union to enlarge to the east – in readiness for a final agreement planned for next month.

Last night, Bonn was still hoping for a farm reform deal this week. However, France was among countries which rejected yesterday's compromise package, saying it was "unacceptable". Some diplomats said talks could go into next week and beyond.

The German presidency and the commission yesterday outlined a compromise which would cut by 25 per cent the prices which farmers are guaranteed for beef. In the previous 18 months of talks, the commission had insisted on a 30 per cent cut.

The compromise also suggested guaranteed milk prices could fall just 10 per cent, up from the 15 per cent suggested earlier. Greece, Italy and Spain were offered the possibility of lifting production.

Even if the price cuts are lower than the commission wanted, the final deal looks certain to be more radical than the first and only big reform of the Common Agricultural Policy, agreed in 1992.

It is likely to include plans for unprecedented annual cuts in direct aid to farmers – after subsidies peak in the next few years – and a reversal of the trend that has increased CAP spending in almost every year since it was set up in 1962. The CAP costs €40bn ($45bn) a year, which is nearly half the EU budget.

The commission held firm on its proposal to cut cereals prices by 20 per cent to bring them down to world levels.

However, it agreed to extend until 2002 the practice of paying farmers to take land out of production. Other concessions included phasing in over three years, rather than one, the commission's plan to reduce direct aid for oilseeds to the level of cereals.

On milk, the commission held out the prospect of abolishing production-limiting quotas in 2006 by offering a review in 2003. The UK, Italy, Sweden and the Netherlands have been pressing hard for abolition but other countries are fighting to preserve quotas.

French and British diplomats said the package unveiled by Germany and the commission would increase reform costs at a time when countries wanted to stabilise EU spending.

The commission acknowledged yesterday's beef and cereals changes would cost €600m annually by 2006. However, the forecasts take no account of the impact of direct aid cuts.

Janet Reno, US attorney-general, talks to reporters about the investigation of special prosecutor Kenneth Starr. Her department is examining some of his methods in the light of the Monica Lewinsky case. Picture: AP

Hoechst link plan thrown into doubt

By Robin Allen in Dubai, Uta Harnischfeger in Frankfurt, David Owen in Paris and Clay Harris in London

Doubt has been cast over one of the world's largest industrial mergers – between Hoechst, the German pharmaceuticals group, and Rhône-Poulenc of France.

The management of Kuwait Petroleum Corporation, the largest shareholder in Hoechst, is said to be divided over whether to support the plan.

The deal, announced in December, would create Aventis, a company with annual sales of $20bn and 95,000 employees. It would be the world's biggest life sciences group, based on 1997 sales. With a 24.5 per cent stake, KPC is in a position to thwart the plan when Hoechst shareholders vote on May 4. The deal requires the support of 75 per cent of all shareholders.

Hoechst, alarmed that the deal could fall apart, has hired Morgan Stanley Dean Witter, the US investment bank, to persuade its Kuwaiti shareholders to pledge their support. KPC has retained J.P. Morgan to advise it on the proposed merger. Morgan Stanley and J.P. Morgan declined to comment.

Sheikh Saud Nasser al-Sabah, the Kuwaiti oil minister who is also ex-officio KPC chairman, said last week the merger did not serve Kuwaiti interests, and a senior KPC official said the group was "undecided" about its reaction to the proposed merger.

Although some close to the situation expect the sole Kuwaiti member of the Hoechst supervisory board, Khaled-saleh Buhamrah, to back the deal, that is only likely to happen if differences in Kuwait can be ironed out. Analysts say KPC's position on Aventis is clouded by apparent divisions within the Kuwaiti hierarchy.

KPC's qualms are believed to centre on the tax implications of the deal and whether the merger is in the best interests of Hoechst. Analysts say the Kuwaitis' doubts may stem from increasing pressure to re-evaluate their overseas assets because of successive budget deficits.

A Gulf-based western banker said management of the overseas assets had become "a critical factor in Kuwait's economic future".

Analysts say KPC has been unhappy about Hoechst's direction since it bought its first stake in 1982, when it bought into other large German companies.

Warning over flood of euro counterfeits

By John Willman in London

Arrangements for minting two of the new euro coins could lead to a flood of counterfeit coins that would undermine confidence in the European Union's new currency, vending machine operators warn.

The opportunity for counterfeiters comes from the failure to set a standard for the electrical resistance of the new €1 and €2 coins.

These will be popular for vending machines selling soft drinks and cigarettes, as well as ticket machines on public transport and parking meters.

Variations in production methods in the EU's 15 mints mean the bimetallic coins are likely to have widely differing "electronic signatures" as far as the EU's 9m vending machines are concerned. If the machines are programmed to accept such a variety of coins, it will be easier for counterfeiters to produce substitutes.

The alternative is to make the machines more choosy about the coins they accept. The machine operators believe this would lead to frustration among users and increase concerns at the time of the changeover.

The problem is to be discussed at a meeting between the European Vending Association and the EU mint directors' committee next month. The machine operators believe standardisation would not need further legislation, but action is needed with some countries beginning to mint coins.

"The industry wants something to happen quickly," said Catherine Piana of the EVA.

The problem is the second to emerge with the new coin set, which goes into circulation in the countries that have adopted the single currency in 2002.

Earlier this year the machine operators and organisations representing Europe's 7.5m blind and partially sighted people called for changes in the weight and feel of two low-denomination coins to make them easier to distinguish. New specifications were adopted this week for the 10 cent and 50 cent coins to meet these demands.

The problem this time comes because the coins are made from two metals. Establishing a consistent electronic signature is more difficult because of the combination.

Saudi central bank intervenes to support riyal

By Roula Khalaf in London

Saudi Arabia's economic problems resulted in heavy intervention in currency markets yesterday by the Saudi Arabian Monetary Agency as pressure grew on the riyal.

One banker said SAMA, the kingdom's equivalent of a central bank, "flooded" the market with dollars. The last time the agency intervened was last summer, when, in the wake of the Russian crisis, it is believed to have spent close to $1bn to support the riyal.

With the outlook for oil prices not expected to improve, Saudi Arabia's oil-dependent economy is facing one of its most difficult periods and public finances are expected to come under further strain. That has led some speculators to bet on a devaluation. The six-month forward rate for the riyal, which is pegged to the dollar, is at its lowest for at least nine years.

"After the Brazilian peg went, people have been looking at other fixed rates where public finances are coming under pressure," said a banker yesterday. "Given that the outlook for oil prices is weak, they think Saudi Arabia's current situation will persist."

SAMA in August ruled out a devaluation and bankers said the central bank's position was likely to remain unchanged.

Although much of the short-selling came from big hedge funds outside Saudi Arabia, there were rumours yesterday that even Saudi companies were starting to take action to avoid being hit by a devaluation.

"Some of those who shorted the riyal got burned and this probably stopped the momentum building up," said a banker.

Low oil prices are presenting a daunting challenge for Crown Prince Abdullah, who is managing the day-to-day affairs of the kingdom. They have forced the world's largest oil producer to cut spending by 12 per cent in the 1999 budget. Saudi Arabia's budget deficit last year reached 9.4 per cent of gross domestic product against 1.1 per cent in 1997.

Saudi Arabia has foreign assets of more than $60bn, but estimates of foreign exchange reserves that can be used immediately to support the currency vary widely.

Mohamed El-Erian, managing director at Salomon Smith Barney, said Saudi Arabia had a clean balance sheet on external debt and could raise funds through syndicated loans. "This is also an economy which can reduce public spending very sharply if it has to do so," he said.

BAe's Saudi sales, Page 28

Disaster in the Alps
The latest news on avalanches, and the state of roads and resorts throughout the Alpine region
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WORLD MARKETS

STOCK MARKET INDICES		
New York		
Dow Jones Ind Av	9,282.56	(-137.29)
Nasdaq Composite	2,287.59	(-51.78)
Europe and Far East		
CAC40	4,152.56	(-61.14)
DAX	4,958.58	(-103.78)
FTSE 100	6,208.5	(-101.1)
FTSE Eurotop 300	1,229.11	(-20.61)
Nikkei	14,470.45	(+115.00)
US RATES		
Federal Funds	4.975%	(4.75%)
3-mth Treas Bills: Yld	4.64%	(4.646%)
Long Bond	94⅜	(96⅜)
Yield	5.65%	(5.605%)
OTHER RATES		
UK: 3-mo Interbank	5⅝%	(5⅝)
UK: 10 yr Gilt	110.49	(110.35)
Euro Euribor	3.067%	(3.079%)
Germany: 10 yr Bund	98.30	(98.21)
Japan: 10 yr JGB	99.178	(99.148)
NORTH SEA OIL (Argus)		
Brent Dated	$10.825	(10.68)

GOLD		
New York: Comex	$288.4	(288.7)
London:	$287.85	(287.95)
DOLLAR		
New York:		
£	1.60585	(1.597)
€	0.9043	(0.9085)
SFr	1.4365	(1.448)
Y	119.325	(121.5)
London:		
£	1.6049	(1.5968)
€	0.9049	(0.9130)
SFr	1.4410	(1.4537)
Y	120.10	(121.880)
Tokyo Close		Y 120.82
EURO (London)		
$	1.1051	(1.0954)
£	0.6889	(0.6851)
Y	132.723	(133.501)
SFr	1.5925	(1.5923)

Euro-zone target price €2.15. Prices in local currency as shown

Bahrain	Din1.300	Iceland	Ikr285	Oman	OR1.75
Belgium	BFr90(€2.23)	Italy	L3900(€2.01)	Poland	Zl 10.00
CIS	US$4.00	Jordan	JD1.75	Portugal	Esc320(€1.60)
Croatia	Kn19.00	Kuwait	KWD0.750	Qatar	QR13.00
Denmark	DKr15.00	Latvia	Lg1.65	South Africa	R16
Estonia	EKr34.00	Lithuania	Lt21.00	Spain	Pta325(€1.95)
Finland	Fmk13.00(€2.19)	Lebanon	LBP8.500	Sweden	SKr20.00
France	FFr14.00(€2.13)	Luxembourg	LFr90(€2.23)	Switzerland	SFr3.00
Gibraltar	£0.85	Morocco	Dh18.00	Syria	S£90.00
Greece	Dr500	Netherlands	Fl 4.80(€2.18)	Tunisia	Din2.000
Hungary	Ft380	Norway	NKr19.00	UAE	Dh13.00

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LAFONTAINE WARNING EURO-ZONE MAY SLIP INTO DEFLATION UNLESS ECB CUTS SHORT-TERM RATES, SAYS BONN FINANCE MINISTER

German price inflation nearly zero

By Tony Barber in Frankfurt

German consumer price inflation sank almost to zero in January, providing more fuel for the argument between the centre-left government in Bonn and its critics over whether the European Central Bank (ECB) should cut interest rates.

The Federal Statistics Office in Wiesbaden reported that the consumer price index had risen by only 0.2 per cent last month from its level in January 1998. On a month-on-month basis, the index actually fell by 0.2 per cent in January compared with December 1998.

The virtual disappearance of inflation in Germany has prompted warnings from Oskar Lafontaine, finance minister, that the euro-zone may slip into deflation unless the ECB cuts short-term interest rates from 3 per cent, where they have stayed since early December.

The ECB says European interest rates are already very low by historical standards. It argued in its monthly report for February that the euro-zone might even face an inflationary risk from excessive wage growth and a relaxation of government's budgetary discipline.

Johann Hahlen, president of the statistics office, said Germany was going through a period of price stability rather than deflation.

He noted that the euro's fall of more than 5 per cent against the dollar since early January meant that pressure might grow on German consumer prices from more expensive imports.

Independent economists say the euro's fall makes it unlikely that the ECB will cut rates soon, since such a step could send the currency even lower against the dollar.

Moreover, they say the ECB may believe that headline inflation in Germany and other euro-zone countries is understated because of the distorting effect of significantly lower energy prices.

Germany's annual inflation rate was affected by the use of a new method to calculate inflation. The statistics office changed the base year from 1991 to 1995 and altered the basket of monitored goods and services to reflect new consumer habits.

Economists said that, under the old method, the consumer price index would have been 0.1-0.2 percentage points higher. They said the main reason for the virtual absence of inflation lay in large price declines for heating oil, telecommunications services and motor fuels.

Schröder backed on jobs alliance

By Ralph Atkins in Bonn

Gerhard Schröder, German chancellor, yesterday won pledges from industry to stick for the long term with his "alliance for jobs" programme, after promising to use the forum for closer co-operation on tax policy.

Speaking after the second "summit" meeting of employers, unions and ministers since he took office in October, Mr Schröder said the alliance would not be blown off course by industry's vehement opposition to many of his government's reforms. In future, it would look to seek agreement on tax policy.

Securing the future of the alliance is a boost for Mr Schröder. His government has been forced to retreat in recent weeks on key elements of its programme including reform of nationality laws and the shutdown of nuclear power.

Hans-Olaf Henkel, German industry association (BDI) president, insisted the decision did not signal an end to his criticism of the government. Yesterday, 22 prominent businessmen called for a halt to these planned tax reforms. Mr Henkel said, however, he wanted to keep the alliance going so he could help shape future decisions.

An early issue favoured by business will be Mr Schröder's promises to cap the top tax rate for all companies at 35 per cent from next year. The pledge has put pressure on Oskar Lafontaine, finance minister, who has so far opposed a significant "give-away" for business.

Mr Schröder hinted the "alliance for jobs" could in the future also touch on industry wage settlements – despite unions' determination to preserve the autonomy of pay negotiations.

The alliance for jobs is central to Mr Schröder's plans for cutting Germany's 4m unemployment total and rebuild an industrial consensus which the chancellor argues was a German hallmark but disintegrated under his predecessor, Helmut Kohl. Apart from summit meetings, such as yesterday's, the chancellery has organised eight working groups to cover issues including tax policy, social security reform, working hours and eastern Germany.

The structure has met scepticism from industry. But Mr Henkel of the BDI said he was happier Germany had adopted the Dutch consensus model, which had operated in the Netherlands since 1982, than pursued a "Thatcherite" approach "for which UK society was still paying the price".

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EUROPEAN COMMISSION BRUSSELS PRESIDENT ADMITS TO MOST SERIOUS CRISIS YET IN PUBLIC CONFIDENCE

Santer pledges to fight against fraud

By Neil Buckley in Brussels

Jacques Santer, European Commission president, has pledged to "leave no stone unturned" in the hunt for fraud at the Commission, to overcome what he calls the most serious crisis of public confidence yet in the European Union.

Writing in today's Financial Times, Mr Santer also appeals for the Commission, the EU's executive arm, to be given extra resources to cope with its ever-expanding tasks. Too often, he says, the Commission is asked "to drive a Mercedes with the engine of a Trabant".

His appeal is carefully timed to coincide with today's mini-summit of EU heads of government in Bonn, to discuss the EU's budget for 2000-06.

It comes a month after the Commission narrowly avoided a censure in the European parliament, the EU's only directly elected assembly, over a series of claims of fraud and mismanagement. A successful censure vote would have sacked all 20 commissioners who head the executive.

His promise to "get the house in order" is also part of a charm offensive before publication of a report on March 15 by the five-person "committee of experts" – set up after last month's parliament vote – which is investigating the fraud claims.

Parliament has warned that if the inquiry finds individual commissioners guilty of wrongdoing, it will press Mr Santer to sack them.

MEPs have also threatened to reintroduce their blanket censure motion, their only legal sanction against the Commission, if they feel it is not doing enough to tackle shortcomings.

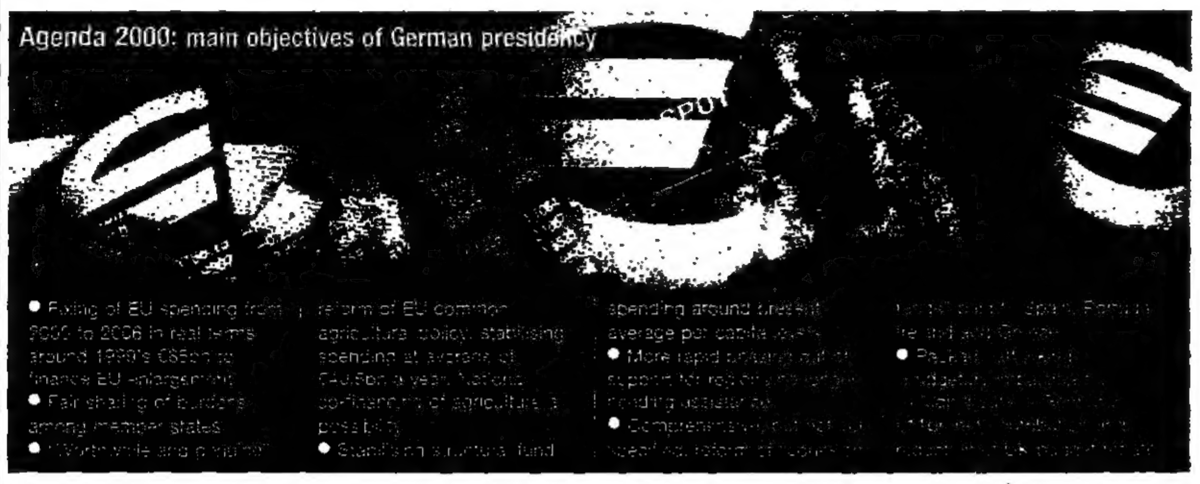
Tensions have again run high between the two institutions this week. Edith Cresson, education commissioner, was mauled by parliament's budgetary control committee over the award of a lucrative EU research contract to a dentist acquaintance.

Mr Santer goes further than previously in acknowledging a "crisis of public confidence" over the handling of EU finances, which is "not the first...but by far the most serious".

He adopts a noticeably more contrite stance towards the censure vote. At parliament in Strasbourg last month, he insisted the 293-232 vote against censure represented a vote of confidence in him and his team.

Now, he admits the assembly only "narrowly avoided" censure and delivered a "salutary reminder". He welcomes parliament's action as a sign that "democracy is coming of age at European level".

Personal View, Page 18



Fischer out on a limb as EU states agree to differ on Agenda 2000

Negotiations on reform are being hampered by ill-feeling over Germany's role as president, writes **Peter Norman**

Joschka Fischer, Germany's foreign minister, must have had a strong feeling of *déjà vu*.

It was more like a meeting of his notoriously quarrelsome environmental Green party when the minister tried to sum up the German EU presidency's view of progress at the end of last Sunday's "conclave" on European Union reform in Luxembourg.

Without exception, Mr Fischer's colleagues from the other 14 member states objected to his attempt to put a positive gloss on progress in the ambitious Agenda 2000 negotiations over reform of the EU's budget, farm and regional policies. In the end, the conclave, held to clarify issues ahead of today's informal summit of EU leaders in the historic Petersberg hotel near Bonn, simply confirmed known differences.

The stand-off between Mr Fischer and his fellow ministers showed how Germany, as current holder of the EU's six-month rotating presidency, is making heavy weather of the complex Agenda 2000 negotiations.

The plan is to give the EU a clear financial perspective for 2000 to 2006 so the union can take in new members to the east and south. Since assuming the presidency in January, Bonn's strategy has been to try to narrow differences among the 15 member states, taking the main elements of the negotiation in turn, with the goal of a full accord at a special summit of EU leaders in Berlin on March 24-25.

Spearheaded by Dietrich von Kyaw, Bonn's veteran ambassador to the EU, German negotiators are seeking agreement on cutting EU spending on agriculture and limiting the structural funds for poorer regions and other outlays on research, development and administration.

These are the elements on the expenditure side of a "negotiating box" which Germany has presented to its partners and which is supposed to evolve into a draft settlement for the Berlin meeting. The box is revised to reflect discussions each month among the EU's foreign, finance and farm ministers and negotiating sessions of the member states' EU ambassadors in their powerful "Coreper" committee which handles much of the day-to-day decision making in Brussels.

The negotiations on spending have proved predictably contentious. All member states say they see the merit of controlling EU expenditure when national budgets are tight and the union has to finance enlargement.

But expenditure control – encapsulated in the presidency's idea of stabilising the EU outlays in real terms around the 1999 level of €85bn ($95bn) – involves pain, and no country is prepared to be the first to sacrifice cherished entitlements. The most vocal is Spain, which regards its income from the "cohesion" funds intended to help it prepare for economic and monetary union as sacrosanct.

Other aspects of the EU finances are equally fraught because important national interests are involved. "The steps forward have been very, very small," said one foreign minister reviewing progress over the past two months. This applies especially to problems of EU financing and the "budgetary imbalances", by which some countries, notably Germany, pay a disproportionate share to Brussels.

Germany's determination to use the negotiations to cut its €11bn net contribution to the EU is an extra problem. Other countries argue Bonn is compromised and unable to fulfil the "honest broker" role required of a presidency in a big EU negotiation. "The presidency is doing the job of the German delegation," complained one Spanish diplomat. Fuelling the ill feeling is Bonn's refusal to close out options for settling the budgetary imbalances that are anathema to other member states.

These include an "adjustment" or reduction to the UK budget rebate, negotiated in the 1980s by Margaret Thatcher when she was prime minister and firmly defended today by Robin Cook, the foreign secretary. Another sore point is Bonn's backing for increased national co-financing of agricultural support, which is viscerally opposed by France because France alone would be a significant loser from such a policy.

During the talks last Sunday, Mr Cook appeared unruffled when faced by 14 EU partners demanding cuts in the UK rebate. But the recent negotiations have produced pained expressions of incomprehension among French diplomats. "There is no proper dialogue between France and Germany," said one French diplomat.

Germany has rebuffed what Paris calls a "global" approach to the negotiations, which France claims would cut Germany's annual net contribution by about €3bn, mainly through stabilising EU spending.

Instead, Bonn's insistence that co-financing should remain on the table has fuelled French fears that Germany will use it in an "ambush" in the final stages of the Berlin summit to solve any negotiating impasse.

Rightly or wrongly, France believes the centre-left government of Germany's Chancellor Gerhard Schröder is breaking an unwritten rule of the Franco-German relationship by persisting with a policy that is fundamentally hostile to French interests. In the past, the French say, neither France nor Germany would press a policy opposed by the other partner.

For their part, German diplomats say the complaints are a sign the negotiations are moving, albeit painfully, towards a compromise in which every state will have to give up something. "We are between the third and fourth acts of a five act drama," commented one.

In his invitation to today's informal summit, Mr Schröder made clear that the meeting has not been called to forge agreements. Given the bad blood of recent negotiations, he will have to take care that Agenda 2000 is not heading for derailment.

Art sales levy measure postponed

By Emma Tucker in Brussels

Germany yesterday backed away from a confrontation with the UK over controversial proposals to impose a harmonised levy on art sales in the European Union.

EU diplomats said other member states had agreed at a meeting of internal market ministers to postpone adoption of the resale-right directive to save Tony Blair, the British prime minister, from a spate of anti-European newspaper headlines ahead of today's meeting of EU leaders in Bonn and just days after he unveiled preparation plans for a changeover to the euro.

But officials said they expected "early agreement" on the proposal after further examination of the most contentious issues.

The draft directive would give artists a royalty from the onward sale of original works up to 70 years after they die.

London's auction houses claim the levy – which does not exist in the UK, Ireland, the Netherlands or Luxembourg – would drive arts sales out of the EU to Switzerland and the US.

But other member states say different regimes within the EU distort the art market. They have already mustered enough votes within the council of ministers to outvote the British, and the other opposing member states. As the directive introduces a copyright royalty, rather than a tax, it only requires the support of a qualified majority of member states to become law.

Germany, which holds the rotating EU presidency, is ready to offer Britain further concessions on the directive to win its approval.

These would primarily lower the levy to be charged on the most expensive works of art.

Under the current proposals there would be a royalty of 1 per cent on the portion of the sales price of a work of art exceeding €200,000 ($224,000). Under the expected compromise 0.5 per cent would be levied on the portion exceeding €500,000.

Monti hints at altering 'grey goods' law

By Emma Tucker in Brussels

Mario Monti, single market commissioner, yesterday hinted at good news for supermarkets and other non-specialist retailers wanting to sell cheap imports of luxury goods, when he said he was inclined to alter the EU law stopping them doing so.

"If I am provided with satisfactory evidence that such a move would have the ultimate effect of reducing consumer prices without any detrimental effect on employment, I would tend to look at it not only with an open, but a favourable mind," he said after an internal market council meeting in Brussels.

Mr Monti had presented EU ministers responsible for the single market with a report showing that scrapping EU restrictions on "grey" imports would probably only produce small immediate cuts in retail prices.

However, the report by National Economic Research Associates (Nera) is contested by the European Parallel Import Coalition (Epic).

It says its own research reveals that liberalising grey imports would have a dramatic effect on consumer prices.

Simon Milward, chairman of the coalition, claimed: "Simply put, the European consumer gets a raw deal and pays too much to branded-goods manufacturers who control the market".

The Nera report was ordered by the Commission as a starting point for discussions on whether to relax the EU's trademark directive which blocks "grey" imports from outside the EU.

The Commission called for it last year after the European Court of Justice ruled that the directive prohibited such imports.

However, any modification of the law is likely to be hotly contested by France which yesterday made clear that it was opposed to any change.

The UK, Ireland, Denmark, Sweden and Finland support a relaxation of the rules.

Most branded manufacturers also oppose a change, but supermarkets and other general retailers say the EU law undermines free trade.

Any Commission proposal would have to win the support of a qualified majority of member states to become effective.

NEWS DIGEST

BELARUSAN PRESIDENT

Lukashenko regrets giving up N-weapons

Alexander Lukashenko, Belarusan president, said yesterday his country made a big mistake when it gave up Soviet nuclear missiles and hinted he would like a new nuclear arsenal, Interfax news agency said.

Mr Lukashenko, in Moscow for a meeting of five former Soviet republics, told Interfax in an interview that nuclear weapons in Belarus might help guarantee the security of a loose union being created by his country and Russia.

"I considered and consider it a big mistake [giving up nuclear weapons in the 1990s]," he was quoted as saying.

"In the opinion of A. Lukashenko, nuclear weapons could in the current situation be brought back to Belarus," Interfax said, paraphrasing Lukashenko's words. "We must think about the safety of our common fatherland."

Belarus was home to 72 SS-25 single-warhead missiles when the Soviet Union broke up in 1991. Their removal to Russia was partially funded by the west.

Mr Lukashenko, whose Soviet-style economics and human rights record have left Belarus diplomatically isolated and cut off from western aid, said a "unipolar world" had emerged after the break-up of the Soviet Union. "It is impossible to allow that one leader or one country to act like an elephant in a china shop," he said in a reference to the US.

He also said Nato's eastward expansion posed a threat to Belarus and Russia, as did the desire of some states of the post-Soviet Commonwealth of Independent States to quit its collective security pact. Uzbekistan, Georgia and Azerbaijan are considering leaving the pact.
Reuters, Moscow

DUTCH ECONOMY

Spending spree boosts GDP

The biggest consumer spending spree in more than 20 years fuelled a 3.7 per cent rise in Dutch gross domestic product last year, the Central Bureau for Statistics reported yesterday.

Consumer spending, which accounts for nearly two-thirds of total output, rose 4.4 per cent in 1998. Dutch households spending last increased this much in 1978, the bureau said.

Outlays for durable goods – led by consumer electronics, new cars and household furnishings – rose by 8.7 per cent, almost twice last year's rate and the greatest increase since the 1970s.

The pace of Dutch growth slowed during the year, with fourth-quarter GDP reaching an annualised 3.1 per cent against 3.2 per cent a year before. The CBS said it expected the economy to cool further in 1999. GDP grew by 3.6 per cent in 1997.

The Central Planning Bureau, a government think-tank, said last week that it would probably slice this year's GDP forecast to 2 per cent from 2.25 per cent.
Jeremy Gray, Amsterdam

SLOVAK EX-MINISTER

Parliament lifts immunity

The Slovak parliament has removed parliamentary immunity from a former minister of interior, so that he can be prosecuted for cancelling a referendum the previous government opposed.

The vote on Gustav Krajci is the first time parliament has allowed a deputy to be prosecuted and is likely to be followed shortly by the removal of immunity from Ivan Lexa, the former head of the secret service, who is alleged to have masterminded the kidnapping of Michal Kovac, the son of the former president.

The cancelling of the referendum for direct elections to the presidency in 1997 and the kidnapping of Mr Kovac in 1995 have long been seen as part of the conflict between the former government of Vladimir Meciar and the then president, which destroyed Slovakia's chances of joining Nato or the fast-track negotiations to the European Union.

The new Slovak government, which took office in October, has tried to expose wrongdoing by its predecessor and has purged the bureaucracy, diplomatic service, state-run media and state-owned companies of its appointees. It is also planning to reverse some of its suspect privatisations, notably of gas storage company Nafta Gbely.
Robert Anderson, Prague

SPANISH TRADE

Import-export gap widens

Spain suffered the biggest trade shortfall among euro-zone countries last year as the gap between imports and exports widened by 31.5 per cent to Pta3,548bn (€21.3bn, $23.5bn), according to customs figures.

Economic crises in overseas markets and slower growth by key customers such as Germany and Italy acted as a brake on Spanish exports, which rose 6.7 per cent during the year to Pta16,290bn, while imports climbed 10.4 per cent to Pta19,838bn.

However, the economy ministry said Spain's foreign sales were still rising faster than the overall expansion of world trade, nudging the country's global market share up from 1.95 per cent to 2 per cent.

The deficit in merchandise trade was offset by a record year for tourism, which brought Spain net revenues of about Pta3,600bn, the ministry said. It expected an overall surplus in goods and services equivalent to 0.4 per cent of gross domestic product. **David White, Madrid**

FRENCH BANKS

Interest rates for savings cut

Crédit Agricole and Banque Nationale de Paris, two of France's three largest banks, yesterday cut the interest rates they pay on savings accounts from 3 per cent to 2.5 per cent.

The move, which follows comments this week by Jean-Claude Trichet, governor of the French central bank, that state-controlled savings rates were "too high", increases pressure on the government to reduce these rates.

Last year, the finance ministry laid out strict rules to determine the level of savings rates. Although the rules point to a level of no more than 2.5 per cent, the government has so far failed to bring the rates down from the current 3 per cent.

Private sector banks complain that state-controlled rates, available only on tax-free savings products – the *Livret A* – offered by the public sector savings bank Caisse d'Epargne and the post office, distort competition in the banking sector.

Savings accounts – or *livrets* – are the country's most popular savings instrument. *Livrets* offered by private sector banks, whose customers must pay tax on the interest they receive, have struggled to compete with the *Livret A*.

Association Française des Banques, the banking industry's trade association, said the move by BNP and Crédit Agricole would "push the government to lower state-controlled rates, which are too high in the current market conditions". **Samer Iskandar, Paris**

KURDS PUBLIC PROSECUTOR ACCUSES PKK OF INTIMIDATION

Turkish move to ban Hadep party

By Leyla Boulton in Ankara

Turkey's public prosecutor yesterday sought to ban Hadep, the country's largest pro-Kurdish party, from general elections on April 18 in a move the party called a serious blow to the poll's legitimacy.

Vural Savas, the public prosecutor who secured the closure of the Islamist Welfare party in 1997, said he had "serious information" that the PKK guerrilla group – whose leader, Abdullah Ocalan, was captured by Turkey last week – was intimidating Kurds ahead of the poll to force them to vote for Hadep.

Mr Ocalan yesterday saw his lawyers for the first time since his arrest on February 15. But the governor of the Bursa region, whose authority extends to the island prison where Mr Ocalan is being held, told the defence team to stick to its brief of defending the captured guerrilla chief.

The governor's remarks were a clear warning to the lawyers, who are connected to Turkey's human rights movement, to stay away from wider issues such as human rights and Kurdish grievances in the south-east of Turkey, where Kurds form a majority.

Mr Savas' application to the Constitutional Court for a pre-election ban against Hadep marks an important step beyond his earlier move to close the party on the grounds the party had an "organic" link with the PKK – a charge rejected by Hadep.

"If they want to kill the party they can," said Mehmet Satan, a member of the party's executive board. "But if they take a decision like this, the legality of the election will be finished."

Hadep said the public prosecutor had timed his latest attack to follow the expiry of Wednesday's deadline for all Turkish political parties to submit their lists of candidates for the parliamentary and local elections. This meant depriving Hadep candidates of the alternative option of registering as independents.

Turkish newspapers also published new alleged confessions by Mr Ocalan, who was said to have told his interrogators Hadep was connected to the PKK. Hadep said yesterday the only thing the two had in common was their desire for a solution to Turkey's Kurdish problem.

In Germany, hit by violent Kurdish protests since the capture of Mr Ocalan, security chiefs called yesterday for the PKK to be reclassified as a terrorist group.

This would give the authorities wider powers to control the PKK on German soil.

Greece meanwhile evacuated three aides to Mr Ocalan who had been holed up in its embassy in Nairobi along with Mr Ocalan before he was seized and flown back to Turkey to face trial for treason. Turkey holds Mr Ocalan responsible for a 15-year conflict between the PKK and the Turkish armed forces in the country's south-east, at the cost of up to 30,000 lives and $7bn a year to the Turkish treasury.

Kosovo deal pledged by moderates

By Guy Dinmore in Pristina

Members of the Kosovo Albanian delegation to peace talks in France flew back to Pristina yesterday, pledging that hardliners in the Kosovo Liberation Army (KLA) who prevented signature of a deal at the talks would not be allowed to prevent a final agreement when negotiations resume on March 15.

Veton Surroi, who played a moderating role within the 16-strong Kosovo Albanian delegation, accused Adem Demaci, a KLA political representative, of trying to block the proposed agreement, which would give Kosovo broad autonomy within Yugoslavia but not independence.

"One man or group cannot hold hostage all of Kosovo," Mr Surroi said in the offices of his Albanian language newspaper, Koha Ditore.

Mr Surroi's comments confirmed the impression created at Rambouillet that there are deep divisions within the KLA, which will have to be resolved before a peace agreement is possible.

Sources close to the KLA said Mr Demaci, a veteran campaigner for secession who spent 28 years in Serbian prisons, had staged what amounted to a coup within the KLA while the delegation was in France. Mr Demaci was named the rebels' chief political representative and appears to have engineered the appointment of Suleiman "Sultan" Selimi as the first overall military commander of the KLA.

After 17 days of talks in the Rambouillet château outside Paris, the ethnic Albanian delegation – which included four senior KLA members – agreed to accept the deal in principle and consult their people before returning to sign on March 15. Serbia expressed reservations about the US-drafted political text and rejected plans to send a 28,000-strong Nato-led peacekeeping force to Kosovo.

"This is a historic moment," Mr Surroi said. "This is the time for peace and that's the feeling of the people of Kosovo, not an abstract notion but a peace secured by Nato, where you get a chance to build democratic institutions not seen by generations. By March 15 we will sign, but what will happen before then I don't know."

Mr Demaci has also attacked an agreement made within the delegation to form a "provisional government" headed by a prime minister from the KLA, which will hold office until elections take place nine months after a peace accord is signed.

At Rambouillet, Hasim Thaci, the 29-year-old head of the KLA's political directorate, emerged as the leading figure, but he appears to have been constrained by influence wielded by Mr Demaci from outside the château. Ibrahim Rugova, who opposes the use of violence and was twice elected to a parallel presidency by ethnic Albanians in 1991 and 1998, was marginalised.

KLA sources said Mr Demaci had support from militant nationalists in exile and from a small number of hardcore fighters, but lacked backing from a people tired of war.

Agreement among the Kosovo Albanians to sign a peace deal would give the western powers a free hand to put pressure on Slobodan Milosevic, the Yugoslav president, to follow suit. But so far Belgrade has dismissed the threat of Nato air strikes. Mr Surroi and others fear Mr Milosevic will try to reignite war in Kosovo to destroy the peace process before March 15.

Ethnic Albanians in Kosovo: KLA hardliners are accused of blocking proposed autonomy deal Reuters

Rome agrees sale of airport stake

By James Blitz in Rome

The Italian government yesterday gave the green light to the sale of its 54 per cent stake in Aeroporti di Roma (ADR) later this year, initiating the first in a series of privatisations it has pledged to carry out before the year 2000.

The government's majority stake in ADR is held by Iri, the state holding company, and is worth about €895m ($994m) at current prices. The government has decided to sell a 51 per cent stake in a single block following a competitive tender, while the remaining 3 per cent of the shares will be offered to Rome's regional authorities.

ADR runs Rome's Fiumicino airport, which had passenger traffic of 25m last year, and the smaller Ciampino airport. It also owns 20 per cent of ACSA, the South Africa-based airport company said by ADR to be the biggest in Africa.

The government made clear that the consortia bidding to buy ADR would have to produce an industrial plan that developed Fiumicino as a European hub.

Several consortia are thought to be interested in bidding for control of ADR, including a group that brings together British Airports Authority and Carlo De Benedetti's CIR industrial holding company. BAA already has a 70 per cent stake in Naples airport.

Several Italian consortia are also thought to be lining up for the bid. One brings together the Benetton clothing group and the Pirelli tyre manufacturer.

Another brings together SEA, the Milan airport authority, and Mediobanca, the Milan-based merchant bank. Amsterdam's Schipol airport is thought to be interested in a separate tender.

One of the issues facing any bidder is that, under new Italian takeover rules, the winner would have to be ready to buy the entire stock of shares in ADR, if offered. This is worth around €1,658m at current prices.

The sale of the stake in ADR is one of a series of privatisations the government has pledged to carry out this year and which are aimed at raising around L15,000bn (€10.2bn, $8.6bn) for the Treasury.

The Treasury must meet this target if it is to come anywhere near achieving its aim of cutting Italy's national debt to 107 per cent of gross domestic product by the end of 2001.

The government aims to sell its 87 per cent stake in Autostrade, the state-run motorway network later this year.

It plans to sell more of its remaining stake in Alitalia, the Italian national carrier. Iri still holds some 53 per cent of the national airline.

Dutch to overhaul law on part-time workers

By Gordon Cramb in The Hague

A Dutch law aimed at protecting part-time and contract workers is to be overhauled only weeks after it came into force because employers have been terminating temporary posts to avoid the extra burdens imposed by the legislation.

"We will evaluate it sooner than we were intending to," Annemarie Jorritsma, economics minister, said in an interview. "It was not the intention to have less part-time work."

Schools shed supply teachers and hospitals crossed relief nurses off their books when the 'Flexibility and Security Act' entered effect at the beginning of the year. The upheaval has even reached professional football, where players are for the first time being offered a collective wage and conditions agreement by clubs anxious to circumvent the impact of the law.

Among its provisions is that after someone serves three temporary contracts and is offered further work within three months by the same employer, he or she is entitled to join the staff. Those employed only on call, but brought in for at least 20 hours a month for three months in a row, gain in most cases the right to a fixed contract.

According to Hans Blankert, chairman of the VNO-NCW employers' federation, the main problem came at temporary employment agencies, which were obliged to offer contracts to those whose services they regularly hired out.

The Netherlands has the world's highest proportion of temps in the workforce.

But Mr Blankert insisted yesterday that these and other difficulties had largely been resolved. The law was the result of a joint proposal by the VNO-NCW and the FNV, the country's main labour grouping. The union side held out for past work records to be taken into account, however, rather than starting each score-sheet afresh at New Year. This brought the flurry of lay offs by managements worried they might unwittingly be taking on permanent staff.

For their part, employers gained the ability to renew fixed-term contracts without having to apply to a labour office or industrial court for exemptions from the protective provisions of standard Dutch labour law.

Mrs Jorritsma, saying the intention of any revisions would be to make the new act less complex, added that unions and employers were obliged to implement it in practice as well as they could. The review should be completed by the summer.

"Unions in the meantime have also become convinced that flexibility in the economy is one of the conditions we need to compete within Eruope," she said.

Russia attacks sanctions drive

By John Thornhill in Moscow

The Russian government yesterday hit out at US moves to impose sanctions on 10 Russian organisations alleged to be helping Iran develop nuclear weapons technology, sharply escalating the war of words between Moscow and Washington over the issue.

"We categorically will not accept attempts to talk to Russia in the language of sanctions and pressure," the foreign ministry said. "Russia unwaveringly supports the principles of non-proliferation of weapons of mass destruction and the rocket systems used for their delivery."

The Russian government also expressed its objections first hand to Strobe Talbott, the US deputy secretary of state, who was in Moscow this week to pave the way for a forthcoming meeting between Al Gore, the US vice-president, and Yevgeny Primakov, Russia's prime minister.

Russia claims its involvement in an $800m project to develop a civilian nuclear power station at Bushehr on the Gulf Coast is purely for civilian ends, and would not help Iran develop a nuclear weapons programme. Officials in Moscow reject US and Israeli suggestions that Iran is a nuclear threshold state, saying it would take the country more than 10 years to develop such a weapons programme.

The Russian foreign ministry was reacting to the US Trade Department's recent publication of a list of seven companies and three institutes allegedly connected with Iran's nuclear programme.

The US administration has said it will cut off links and financial assistance to these organisations – although this is expected to have little practical effect.

Relations between Moscow and Washington have become increasingly frosty in recent weeks following disputes over Iran, Iraq, Kosovo, and possible revisions to the 1972 Anti-Ballistic Missile treaty. But both countries have stressed that these disputes reflect disagreements between partners rather than a rupture of relations.

But Moscow's objections to the US administration's stance will be tempered by the need to persuade Washington to extend further financial support to Russia.

Plea to Chinese PM on telecoms

By James Harding in Shanghai

Foreign telecoms companies operating in China have appealed to Zhu Rongji, the prime minister, to protect their $1.3bn investments and to allow further international participation in the world's fastest-growing telecommunications market.

The confidential letter to Mr Zhu underlines the depth of anxiety among foreign investors that a government review of foreign involvement in the telecoms sector could prompt Beijing to bar further overseas participation and jeopardise foreign ventures in China.

In a submission drawn up by PricewaterhouseCoopers, the accountancy and business services firm, a group of foreign investors in China Unicom, the second and much smaller state telecoms carrier, warns that if Beijing is seen to go back on its commitments it may discourage foreign investment in other sectors.

"This is a time of many uncertainties in Asia and around the world. If the door is closed now to foreign investment in the sector, opening the door again in a time of acute need will be both costly and time consuming. It could have a major negative impact on many aspects of China's development," the investor group says.

The fate of foreign investments in China Unicom have been in doubt since Wu Jichuan, the telecoms minister, accused the ventures of "irregularities" and announced that the government would clean them up "one by one".

The ministry has since softened its position slightly, carrying out an investigation into the ventures and laying out its recommendations for the rationalisation of the sector before Mr Zhu.

Some 46 foreign telecoms companies, including Deutsche Telekom, France Telecom, Sprint of the US and Bell Canada, have injected capital into projects with China Unicom, which was established in 1994 as competition for the much larger carrier, China Telecom.

The foreign invested ventures have followed a so-called "Chinese-Chinese-Foreign" (CCF) format, circumventing the prohibition on foreign equity participation in China's telecoms sector by establishing a complex framework that enables them to derive earnings from management contracts, leasing agreements and consultancy fees.

However, the foreign investors are also dissatisfied with the CCF arrangement. They call on Mr Zhu to allow greater market access, enabling CCF investors to move to "normal equity participation".

EU to press case for poor

By Frances Williams in Geneva

The European Union yesterday called for developing country interests to be given prominence in the new round of global trade talks to be launched at a World Trade Organisation ministerial meeting in the US later this year.

Brussels is urging all industrialised countries to follow its example in granting duty-free access to "essentially all" imports from the very poorest countries, by the time ministers meet in Seattle in November. The EU hopes for a similar gesture by some advanced developing countries.

Presenting preliminary views on the new round to a WTO meeting in Geneva, EU officials also called for the elimination of very high "peak" tariffs on industrial goods, particularly those of concern to developing countries such as textiles, as part of a broader tariff-cutting negotiation.

EU officials said yesterday they expected this negotiation to include the tariff-reduction package passed on to the WTO by the 21-member Asia-Pacific Economic Co-operation forum after Japan blocked a deal on fish and forestry products at the Apec summit last November.

The US then said it hoped agreement could be reached on the nine-sector package this year, but Japan has consistently argued that it should form part of wider tariff negotiations. The other sectors concern environmental products, medical equipment, chemicals, energy goods, toys, gems and jewellery, and telecommunications equipment.

The EU's concern for developing country interests partly reflects its desire to maximise support for a comprehensive round of talks, lasting about three years, that will reduce the focus on farm trade liberalisation.

Breakdown of UN talks on GM crop treaty threatens to heighten trade tensions

The biosafety protocol has been undermined by a clash between the interests of US multinationals and European consumers. **Our International Staff** assesses the implications

When talks on the "biosafety protocol" began in Colombia two weeks ago, this obscure-sounding United Nations treaty on regulating trade in genetically modified organisms (GMOs) received little attention.

But after the acrimonious breakdown of the talks on Wednesday, concerns are mounting that the failure could have serious ramifications for international trade by heightening tensions between the US and Europe.

The inability of the 132 countries present in Cartagena to reach agreement reflected a clash between the trade interests of US and other GM-crop exporters and the environmental concerns of other countries. Intense public concern about the environmental impact of GMOs has prompted several European countries to defy EU agreements and declare unilateral bans.

EU officials are concerned that the failure of the Cartegena talks will strengthen the hand of those in Europe pressing for further bans on GMOs. "It is a disastrous outcome. The danger is that it will be heavily 'spun' as a case of sabotage by US multinational companies," one said.

Greenpeace, the international environmental pressure group, responded to the failure of the Cartagena talks by calling for national import bans. "In the absence of any international regime it is clearly now down to individual nations to do what they can." it said.

EC officials are also concerned that the failure of the talks will put further pressure on its strained relationship on trade with the US. "The EU was trying to act as honest broker. But the US mistrusts what it says, because of the rising resistance to GMOs in Europe," said an official.

One of the main stumbling blocks to a treaty was US insistence that World Trade Organisation rules must take precedence over any biosafety agreement - even though the US has long chafed at submitting its own environmental regulations to WTO disciplines.

The US-led Miami Group, a six-member coalition of the main GMO producers including Canada, Argentina and Australia, feared billions of dollars-worth of trade in agriculturally commodities – an increasing proportion of which are genetically-engineered – would otherwise get tied up in red tape.

Philippe Sands, a barrister and co-founder of the Foundation for International Environmental Law and Development, said that it was clear that the US needed to nip the protocol in the bud, as it would have had dramatic consequences for its agricultural trade. But the US action might backfire if many countries took unilateral action to prohibit imports of GMOs, he said.The biotechnology industry, which was heavily represented at the Cartagena talks, was relieved that talks on the protocol were suspended until a later date. "Suspension will help because it gives us time to go back and talk to our respective governments to try to rid the draft text of all its protectionism and make it fulfil the original mandate for which it was created," said Mario Rodriguez, director of Pulsar International, a Mexican-based seed company which produces approximately 25 per cent of the world's fruit and vegetable seeds.

But industry representatives – without exception – also underscored the importance of having a protocol. "From a business standpoint, we are interested in a clear, uniform international regulatory structure where we know what is expected of us," said Willy De Greef, Head of Regulatory Affairs and Government Affairs of Swiss-based Novartis Seeds, one of the largest seed companies in the world.

But in the bitter aftermath of the Cartagena talks, few participants are optimistic about the prospects for the next round of negotiations.

Reporting by Vanessa Houlder, Guy de Jonquières and Adam Thomson

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A Novartis researcher extracts DNA from leaf tissue to investigate how plants resist fungus infection. The Swiss company wanted the Cartagena talks to set clear international rules

NEWS DIGEST

MERCOSUR TENSIONS

Brazil resists calls for temporary tariffs

Further trade liberalisation in Mercosur, the South American customs union, will be put on hold until the region has recovered from its economic downturn, said Luiz Felipe Lampreia, Brazil's foreign minister. "The important thing is to protect what we have already achieved and stop it from unravelling," said Mr Lampreia. "Once we accept the idea of temporary quotas and higher tariffs, Mercosur will begin to unwind." Mercosur, which also includes Argentina, Uruguay and Paraguay, has been put under strain as a result of the Brazilian currency crisis, which has seen the Real devalue by around 40 per cent.

Industrialists in Argentina have been particularly vocal in calling for protectionist measures to defend them against a potential avalanche of Brazilian exports. Mr Lampreia said Brazil had already made a number of concessions to its Mercosur partners, including stopping export credits for consumer goods. The central bank had also eased restrictions for financing imports into Brazil from the Mercosur countries.

Mercosur has established zero tariffs for trade of most goods between partner countries. However, progress on liberalisation of areas such as services and government procurement has been slower. **Geoff Dyer, Brasilia**

CHINA'S ENTRY TO THE WTO

Congress bill seeks voice

Richard Gephardt, House minority leader, will break ranks with the White House by introducing a bill requiring congressional approval before the administration supports China's admission into the World Trade Organisation.

The legislation, which has Democratic and Republican co-sponsors, would require the US to withdraw from the WTO if China is admitted without US support. The administration is pressing for China's admission before another round of multilateral negotiations. Several administration officials, including the trade representative and the commerce secretary – are scheduled to hold meetings in Beijing before the visit of Zhu Rongji, Chinese premier, to the US in April. There is some congressional concern that the administration, in its strong desire for a deal, will make too many concessions. **Nancy Dunne, Washington**

VIETNAM IMPORTS

Hanoi to waive tariff rises

Vietnam has agreed to waive 50 per cent tariff increases on a range of US goods for at least a year, defusing a potential dispute. The Vietnamese move had drawn protests both from the US embassy and the American Chamber of Commerce in Hanoi, and was threatening to overshadow the resumption of negotiations on a proposed bilateral trade agreement. In January Vietnam introduced the tariff increase on on imports from a list of countries with which it has not yet signed a trade agreement, including the US, Taiwan and Japan. US exports to Vietnam were worth $200m during the first nine months of 1998, against imports from Vietnam of $408m. The two sides remain far apart in the talks on a trade agreement, with differences over the speed and degree of market access for US companies in Vietnam. **Jonathan Birchall, Hanoi**

CURRENCY CRISIS FINANCE MINISTER CONFIDENT THAT INFLATIONARY SURGE WILL BE CONTROLLED

Contraction in Brazil may reach 4%

By Geoff Dyer in Brasília and John Barham in São Paulo

The Brazilian economy will contract by 3-4 per cent this year as a result of the country's currency crisis, according to Pedro Malan, finance minister.

Mr Malan said the government would announce a medium-term inflation target once it had renegotiated the terms of its $41.5m financing package with the International Monetary Fund, which would be concluded "over the next few days".

In an interview yesterday he said he was confident the government would be able to control the inflationary surge caused by the recent devaluation, which would allow interest rates to fall sharply and strong growth to resume next year.

Brazil let its currency float on January 15, abandoning a system of crawling trading bands which had been the anchor of its successful five-year anti-inflationary plan. By mid-afternoon yesterday the currency was trading at $2.05 to the dollar, a devaluation of 41 per cent.

The change in currency regime has forced the government to revise the agreement it signed with the IMF in November, which had been the basis of the bail-out package. In an attempt to re-establish its battered credibility in international markets, the government has raised nominal interest rates to 39 per cent and is preparing a new round of budget cuts.

Mr Malan said inflation would rise over the next few months, but by the fourth quarter of the year the monthly rate would have fallen to 0.5-0.7 per cent, equivalent to an annual rate of about 7 per cent.

Countries such as the US and the UK had been able "to control temporary spikes in inflation through appropriate monetary and fiscal policy", he said.

"The government is committed to preventing inflation coming back and it has the support of society for this."

The government had achieved the target agreed with the IMF for a nominal budget deficit in 1998, including states and state-owned companies, of 8.1 per cent of gross domestic product, although the official figures had yet to be released. As a result of new budget cuts, the government would record this year a primary budget surplus – before interest payments – of "slightly more than" 3 per cent of GDP.

"That is a serious fiscal effort in a country that is experiencing negative growth," Mr Malan said.

Interest rates, the subject of increasing political dispute, would fall sharply if efforts to cut public spending were implemented.

Meanwhile, Demosthenes Madureira Pinho Neto, acting central bank president, said Brazil intended to borrow from international capital markets as soon as "things improve" after an IMF agreement was in place.

He did not say how much Brazil hoped to raise, although the markets expect the country will try to borrow $4bn-$5bn.

NOMINATION CAMPAIGN DARLING OF THE ISOLATIONISTS

Buchanan back to run for president

By Deborah McGregor in Washington

Just one day after taking leave from CNN, Patrick Buchanan wanted to make sure everyone knew he was back - and about to run for president for a third time.

"Buchanan to Address the Great Betrayal of Weirton Steel," blared the press release yesterday from the 60-year-old television commentator, whose "America First" rhetoric has made him the darling of isolationists.

Mr Buchanan will kick off his latest campaign for the Republican presidential nomination in tiny Weirton, West Virginia on Monday. The site was carefully chosen. Weirton (population 22,000), is where 4,400 workers risk losing their jobs if the town's steel plant shuts down.

Hard times in the US steel industry have already resulted in losses and lay-offs at Weirton Steel, the nation's eighth-largest steel producer.

Mr Buchanan blames the global economy for Weirton's woes, making it an ideal place to launch his message that foreign imports are damaging the American economy and sacrificing US workers to globalisation.

"The global economy's apologists in Washington don't like to talk about the Weirtons of America, they would have us believe all Americans are floating on a wave of Wall Street prosperity," Mr Buchanan wrote in a recent fund-raising letter.

He has proved a shrewd election campaigner who is known to be liable to wreak political havoc

"This fiction must be maintained for them to justify the scores of billions of American tax dollars regularly doled out to salvage the wrong-headed investments made in places like Mexico, Russia and Indonesia."

In a year when the US trade deficit is expected to worsen, Mr Buchanan's message is bound to fall on fertile ground. It is likely to fuel protectionist sentiment in Congress and many manufacturing towns across the US heartland.

Mr Buchanan's pitch will pose dilemmas for other Republican contenders. He never comes close to winning the nomination, but has proved a shrewd campaigner who can wreak political havoc in unexpected ways.

He dealt a blow to the candidacy of George Bush in 1992 when he attracted over 37 per cent of the vote in the New Hampshire primary. Four years later, he staggered Bob Dole's campaign by winning in the same state, though Mr Dole recovered to win the nomination.

Mr Buchanan will try to recapture his old momentum by travelling to Manchester, New Hampshire, next Tuesday. There, he will expand on his anti-free-trade, anti-abortion, pro-immigration-controls, pro-isolationist-foreign-policy views before launching a campaign in other primary states.

This time, he is hampered by an absence of his former campaign brains trust. Many of his former aides have joined the camps of rivals such as Steve Forbes and Gary Bauer. But that suggests something about the desire of other candidates to absorb some of the zeal, if not the full menu, of Mr Buchanan's past campaigns.

In part, Mr Buchanan is said to be motivated by his belief that neither George W. Bush nor Elizabeth Dole yet command a solid base of support within the party. At the least, he seems intent on playing the scourge of the party establishment, a role for which he is well-qualified, to party elders' dismay.

Buchanan: scourge of the party establishment

Havana suspends US phones

By Pascal Fletcher in Havana

Cuba yesterday carried out its threat to suspend most of its phone links with the US after five US phone companies failed to make scheduled payments to the island because of an ongoing legal dispute.

The cut-off caused heavy congestion and delays to services from the Cuban side, though some calls were getting through. Most US callers to Cuba seemed able to make connections as some US carriers re-routed through third countries.

Cuba's state-controlled phone company Etecsa had said it would suspend circuits operated by AT&T, MCI WorldCom, LDDS Communications, IDB Communications and WilTel, because they were allegedly withholding payments to Havana owed for calls made in December.

Circuits to Cuba operated by two other US carriers, Sprint and Telefónica Larga Distancia de Puerto Rico, were kept open as they were up to date with payments. The Cuban government said it backed the cut-off decision by Etecsa, a telecommunications joint venture involving Telecom Italia.

High-tech groups respond on accounting

By Roger Taylor in San Francisco

The US technology industry is moving to establish its own set of accounting standards in response to a clampdown on merger accounting by the Securities and Exchange Commission and the Financial Accounting Standards Board.

The move comes in response to the vote this week by the FASB, which sets accounting standards in the US, to stop technology companies from writing off much of the cost of acquiring businesses as a one-off exceptional charge to cover "in-process research and development".

Instead, the full cost of such acquisitions would have to be amortised and deducted from earnings over a number of years. The move, which follows a campaign by the SEC to reduce these write-offs, has prompted protests from the high technology industry which believes the new rules will create the misguided impression among investors that companies' earnings are slowing.

This in turn could undermine the high share prices of many high-technology companies and could result in a temporary slow-down in consolidation in the technology industry.

Chip Vetter, head of mergers and acquisitions at BancBoston Robertson Stephens, said: "There will be a near-term reluctance on the part of boards to enter into transactions until it is clear that investors can see through the accounting changes."

He said investors were already adapting to the changes. Increasingly BancBoston Robertson Stephens analysts were looking at cash earnings, which exclude the amortisation of intangible assets, rather than the financial earnings, he said.

Yesterday the Software and Information Industry Association, the leading trade association, said that it wanted to establish its own set of accounting rules to complement the existing Generally Accepted Accounting Practices. These would allow high-technology companies to present a second set of results which conformed to a standard but which excluding amortised acquisition costs.

The split between the technology industry and the accounting regulators marks the increasingly difficult task of setting financial reporting standards that can be used to compare traditional industrial companies with the newer information and biotechnology businesses which consists largely of intangible assets.

Accounting standards are intended to benefit investors and ensure that they get a true picture of a companies financial performance. However, many investors in the technology industry believe that the proposed new rules will have the opposite effect.

Mr Vetter claimed the ideas of the FASB were absurd when applied to companies "built on intellectual capital". Leading companies in the technology industry, including Cisco Systems and Computer Associates have voiced their unease at the changing accounting rules.

However, there is widespread concern that worse is to come. The currently proposed rule changes would not affect the largest corporate deals which tend to be treated as mergers, but regulators are now said to be considering treating even these as acquisitions.

NEWS DIGEST

MURDER SUSPECT

Israeli bar on extradition set to strain ties with US

Janet Reno, US attorney-general, said she was "disappointed" and warned there was "no safe place to hide" after Israel's Supreme Court yesterday ruled against extraditing a teenage murder suspect to the US. Samuel Sheinbein, 18, will instead stand trial in Israel for allegedly killing Alfred Tello in Montgomery County, Maryland in September 1997. His dismembered body was found burned and dumped in a garage days after Mr Sheinbein, a US citizen, had sought refuge in Israel.

Although there is an extradition agreement between Israel and the US, Israeli citizens are exempt from extradition following a law passed by the late Menachem Begin, who as prime minister believed Jews should not be handed over to gentiles for judgment.

Mr Sheinbein was able to claim Israeli citizenship through his Jewish father, who was born in Israel but settled in the US in the 1950s. Despite this claim, an Israeli lower court last year ruled that since Mr Sheinbein had never lived in Israel he could be extradited. His defence lawyers appealed to the Supreme Court.

Yesterday's decision is likely to strain US-Israeli relations since Madeleine Albright, US secretary of state, and Mrs Reno had personally urged Israel to hand over Mr Sheinbein. *Judy Dempsey, Jerusalem*

US ECONOMY

Orders maintain momentum

The US economy maintained its momentum last month as orders for aircraft and cars boosted durable goods orders by 3.9 per cent over an already strong December, according to the Commerce Department.

In a separate report, the department said preliminary data showed a 6.7 per cent drop in US steel imports in January. This reflects the impact of anti-dumping complaints filed by the US steel industry and union against Japan, Russia and Brazil.

Meanwhile, there were sufficient signs of moderation in the orders report to ward off fears of an overheating economy, which would require the Federal Reserve to raise interest rates. The aircraft category is notoriously volatile. The Economic Data Bulletin, released by Morgan Stanley Dean Witter, noted that the surge in aircraft orders reported by Boeing in December were "finally materialising" in the orders report.

"The underlying pace of activity softened in January with declines in metals and industrial machinery more than offsetting gains in autos and electrical equipment," it said.

Two other reports demonstrated the health of the economy. Sales of existing homes climbed to a record seasonally adjusted annual rate of 5.07m units in January, and the number of workers filing new claims for unemployment benefits fell last week. **Nancy Dunne, Washington**

Irrepressible exuberance, Page 19

MICROSOFT TRIAL

Sun Microsystems accused

Microsoft yesterday attempted to discredit evidence from Sun Microsystems by accusing its software rival of seeking to attack Microsoft's Windows operating system. Bob Muglia, Microsoft's senior vice-president for applications, told the four-month-old monopoly trial in Washington that Sun planned to use its Java technology to make Windows obsolete.

In written evidence released yesterday, he accused Sun of planning to dominate the computer industry. "Sun first planned to popularise its Java programming language and later use that technology as a 'Trojan horse' to ultimately control all aspects of computing, both hardware and software," he said.

Mr Muglia's evidence, while highly critical of its rival, appears to confirm earlier evidence from Sun, which suggested that Microsoft feared its dominance would be undermined by Java. In December James Gosling, vice-president of Sun, accused Microsoft of attempting to block Java by developing its own "polluted" version of the software. **Richard Wolffe, Washington**

On the web today
- Ecuador president struggles to fulfil promise
- Miami split over preserving its past or parking its cars ● Mexico fears rough ride over drugs

http://www.ft.com/americas

China makes threat of missile transfer

By James Kynge in Beijing

Beijing made a veiled threat yesterday to transfer missile technology to unspecified third countries if the US persisted with a controversial plan to provide a missile defence shield for some of China's neighbours, including Taiwan.

China also launched a strong verbal attack on the US, saying that Washington's decision this week to block the sale of a satellite to a Chinese-led corporation would have a negative effect on trade and economic co-operation. Beijing's reaction to the possibility that Taiwan, China's rival since 1949, may be included in a US-backed Theatre Missile Defence (TMD) system has been uncompromising. Officials said a TMD shield for Taiwan, Japan and South Korea would be seen as the start of a cold war policy of containment against China by the US, and could accelerate the regional arms build-up.

It could also be interpreted as US recognition for a separate Taiwanese identity, a senior Chinese official said. Beijing maintains a long-standing threat to use military force to prevent Taiwan becoming independent.

The official, who declined to be identified, said that the installation of a US-backed theatre missile defence system in Asia would constitute a US violation of the Missile Technology Control Regime (MTCR), a treaty which aims to curb the spread of sensitive missile technology.

"Since the US can lead the way in breaking this (MTCR) regime, other countries have an absolute right not to follow the rules of this regime and undertake co-operation on missiles and missile technology with third countries," the official said.

Although China has not signed the MTCR, it has agreed to abide by its principles. In what was hailed as an important sign of progress at last year's US-China summit, Beijing said it would "study" acceding to the regime.

Washington has long been concerned that Beijing could supply missile technology to its ally, Pakistan, thereby fuelling an already fierce arms race between Pakistan and South Asia's other nuclear power, India. China has in the past also made a link between US promises to decrease weapons transfers to Taiwan and a corresponding undertaking by Beijing against arms sales to Iran.

The deterioration in US-China ties provides a stiff challenge for Madeleine Albright, US secretary of state, due to visit Beijing over the weekend to discuss security, and diplomatic issues.

Diplomats said there was a danger that animosity over TMD and the blocked satellite sale could undermine the fragile hope that exists for a deal on China's admission into the World Trade Organisation when Zhu Rongji, the Chinese premier, visits Washington in April.

Both sides have recently made upbeat comments on the possibility of a WTO deal for China, even though the commercial hurdles to such an agreement remain forbidding.

Bank of Japan ignores calls for big boost

By Gillian Tett in Tokyo

The Bank of Japan's policy board yesterday decided to leave monetary policy unchanged in an apparent rejection of calls for the bank to take radical action to boost the economy.

Senior bank officials indicated that it did not plan to raise purchases of Japanese government bonds, in an anti-deflationary move, but would instead continue to guide short-term market interest rates as low as possible.

The announcement may disappoint some of Japan's trading partners, notably the US, which is pressing Tokyo to consider using monetary policy to boost demand.

Lawrence Summers, US deputy Treasury secretary, is likely to raise pressure on the bank to consider new measures when he meets government officials in Tokyo today . He is concluding a tour of Asian countries, which is due to end in Tokyo over the weekend.

The timing of Mr Summer's visit is particularly important since Japanese politicians and senior bureaucrats have recently started to urge the bank to curb the surge in long-term interest rates that occurred earlier this year.

The US has pointedly refrained from spelling out any precise course of action it wishes to see. However, it has warned that unless Japan to take new measures to boost domestic demand, trade friction could rise.

"Japan and Europe both have critical roles to play in achieving broad-based growth in the major industrial economies and helping curb the development of destabilising global imbalances," Mr Summers told the American Chamber of Commerce in Seoul yesterday. "With the Japanese economic situation still very troubling, it is [as] important as it has ever been for the government to take effective steps to achieve its goal of strong domestic demand-led growth."

Although the Japanese government insists the economy will grow by at least 0.5 per cent in fiscal 1999, some senior US officials privately hold a gloomier prognosis.

The scope for Japanese monetary policy measures was a key focus for discussion at the meeting of Group of Seven officials in Bonn last weekend. But Masaru Hayami, bank governor, has hitherto strongly opposed suggestions that the Bank should raise its purchases of JGBs or deliberately create inflation. And western central bank officials admit that easing monetary policy further could be technically difficult. Although the bank let overnight market interest rates fall to a record low of 0.08 per cent last week, this move partly backfired because investors withdrew liquidity from these markets.

However, some western central banks are urging the Bank of Japan to consider introducing targets for inflation or money supply, or even make limited additional purchases of JGBs in secondary markets. And Eisuke Sakakibara, vice-minister of finance who has enjoyed a strong relationship with Mr Summers in the past, claims that the bank is now determined to take "dramatic" steps to boost the economy.

■ Nippon Credit Bank, the nationalised Japanese bank, yesterday claimed the Ministry of Finance had misled private financial companies about the scale of NCB's bad loans two years ago.

The ministry's calculations, which severely underestimated the scale of bad loans, were given to life assurance companies and banks to persuade them to contribute funds to a bail-out of the bank.

The revelation is likely to trigger further anger among these life assurance companies and banks about the manner in which they were forced to contribute around Y210bn ($1.7bn) worth of funds to rescue NCB in 1997.

They argue that the ministry's decision to nationalise NCB last year broke earlier pledges that the ministry had made to the industry.

The dispute marks another deeply embarrassing debacle for the ministry, which is facing growing criticism within Japan for its handling of the banking sector. And with some life assurance companies and banks now threatening to sue the ministry, the battle also highlights the degree to which some traditional loyalties are fragmenting in Japan under the pressure of financial deregulation.

The ministry has tried to claim that the main reason for the underestimates was that the NCB management had been concealing the bad loans. NCB said in 1997 that the total scale of its problem loans was Y700bn, but later revealed that the figure for loans to borrowers requiring careful monitoring was around Y1,120bn.

However, Shigeoki Togo, NCB president, told parliament yesterday that the ministry had produced the earlier bad loan figures. "The figure of Y700bn we reached by adding up the figures given to us by ministry inspectors," he said.

LDP debates military strikes strategy

By Michiyo Nakamoto in Tokyo

Japan's ruling Liberal Democratic party is considering permitting pre-emptive strikes if there is a threat of military action by another country against Japan.

The LDP's crisis management project team, headed by former defence agency chief Fukushiro Nukaga, is looking into the possibility of changing legislation to allow Japan's Self-Defence Forces (SDF) greater flexibility and speed in responding to armed attacks.

The SDF's ability to take pre-emptive action against the threat of an armed attack is crucial in defending the country against a possible missile attack, believes Kenzo Yoneda, a leading member of the project team.

The move would be a radical step away from the government's long-held interpretation of Japan's right to self-defence. It comes as Japan's parliament prepares to implement legislation that would enhance Japan's military role "in situations in areas surrounding Japan" and is likely to cause concern to Japan's neighbours, suspicious of a revival in Japanese military aggression.

According to the common interpretation of the right to self-defence, Japan can resort to military action in self-defence only when there is an armed attack on Japan and no other appropriate means to deal with such an invasion exists.

However, "how much meaning is there to retaliation after the nation and the people have suffered major damage?" asks Mr Yoneda.

North Korean missiles are capable of reaching Japanese territory within six to 10 minutes of being launched. The communist country is believed to have a special force of 80,000 troops which could attack Japan's nuclear power plants or conduct terrorist activities in the country, Mr Yoneda says. Concern about infiltration of North Korean agents was fuelled after the bodies of North Korean soldiers were washed up on Japan's coast last year.

Mr Yoneda is calling for revisions to the SDF Law to allow the SDF to act against intrusions into Japanese waters and land. Under current legislation, the SDF is only allowed to act against violations of airspace.

"The starting point of Japan's post-war crisis management was to try as much as possible to avoid action by the SDF," says Mr Yoneda. But since the launch of the North Korean missile last August, "It became very clear that that was not sufficient," he says.

The LDP project team will compile a report by the end of March and hopes to implement legislation based on it. However, the public is still wary of any divergence from the country's pacifist stance. "There will be political considerations to be taken into account," Mr Yoneda says.

MEETING WITH AUSTRALIANS WILLLINGNESS TO SUPPORT SETTING UP A NEW ADMINISTRATION

Lisbon offers to fund East Timor

By Gwen Robinson in Sydney and Peter Wise in Lisbon

Portugal has offered to finance East Timor, funding an annual budget estimated at more than $100m, as its former colony moves towards a decision on autonomy or full independence from Indonesia.

Portugal, recognised by the United Nations as the administrating power, said yesterday it would meet all its responsibilities to East Timor, both political and financial, as part of a UN co-ordinated agreement on the future of the territory.

The offer came before a meeting between the Portuguese and Australian foreign ministers in Portugal tomorrow that will focus on ensuring a peaceful transition to autonomy or independence.

The territory was invaded and annexed by Indonesia after the Portuguese colonial administration withdrew amid civil strife in 1975. Human rights organisations estimate that more than 200,000 East Timorese have died since the invasion.

Portugal has also set up an inter-ministerial work group to examine East Timor's economic needs and provide support in setting up the administrative framework of an independent state or autonomous region.

Portuguese officials said they hoped Indonesia, Australia and the European Union would contribute support, including finance, for East Timor's transition. But details of when Portugal's financial commitment will begin or how long it will last have not been established.

Portugal's offer appeared partly designed as a response to Indonesian claims that it had developed East Timor more in two decades than Portugal had done in hundreds of years of colonial rule.

A Portuguese official said Indonesia's budget for East Timor was surprisingly small and appeared to belie Indonesia's claims of large-scale development spending.

Diplomats also saw the move partly as a response to John Howard, the Australian prime minister, who has expressed concerns about the potential heavy costs for Australia – the closest country to East Timor – of the transition.

Portugal unsuccessfully sued Australia, the only western government to have recognised Indonesia's annexation of East Timor, for signing a 1989 treaty with Indonesia to explore offshore oil resources in the Timor Gap.

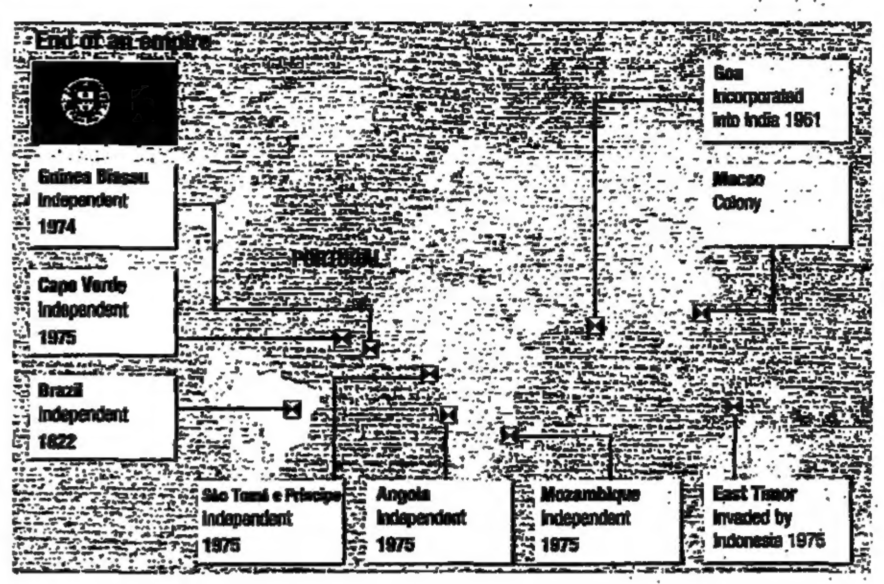
"We are prepared to take a leading role in the transition, and accept all responsibilities necessary," said Jaime Gama, Portugal's foreign minister.

"But we will act only in a UN context. This is not a bilateral matter between Portugal and Indonesia, but an issue between Indonesia and the international community".

Australia has urged Indonesia to stage a gradual, planned withdrawal rather than an alternative proposal to grant full independence by next January.

Portugal endeavours to atone for its colonial sins

Ceding Macao and helping East Timor offers Lisbon a chance to end its empire with dignity



Portugal's endeavour to bring 500 years of empire to a close by averting trauma and violence in East Timor and Macao is suffused with a sense of atonement for colonial sins of the past.

Relinquishing Macao, which returns to China in December, and helping the East Timorese determine their future, is providing an opportunity for a new generation of politicians to redress Portugal's exploitation of its overseas possessions and its chaotic exit from most.

"A feeling of remorse for the transgressions of earlier generations is apparent in Portugal's efforts to bring its colonial history to dignified conclusion," said a European diplomat in Lisbon.

Portugal expects no benefits from its support for East Timor's self-determination, including a commitment to finance the territory if it chooses independence from Indonesia, the government says. The only dividend it hopes for is to keep Portuguese culture alive.

Leaving Macao, settled by the Portuguese 450 years ago and the last European colonial possession in Asia, is not the end of an era but "the beginning of new chapter in relations between China and Portugal," says President Jorge Sampaio.

This view contrasts with the outlook of the authoritarian Salazar regime, when schoolbooks showed an outline of Portuguese empire (East Timor, Macao and five African nations, including Angola and Mozambique) superimposed on a map of Europe, impressing on children that the colonies made Portugal great.

The empire also included Brazil until 1822 and the Indian state of Goa until 1961.

But Salazar's view of overseas possessions as suppliers of cheap raw materials, captive markets for exports and a source of political grandeur fuelled opposition by young leftwing opponents, many of whom, like President Sampaio, are now Portugal's leaders.

The long colonial wars Portugal fought in Africa led to the overthrow of the country's dictatorship by a group of young army captains in 1974. The coup precipitated a hasty withdrawal that left several former colonies beset by conflict.

Angola has fallen back into armed conflict after a brief respite from two decades of civil war. Mozambique suffered 16 years of guerrilla war before a peace agreement in 1992.

Guinea-Bissau is torn by conflict and, like Mozambique, remains one of the world's poorest countries.

In Asia, Portugal is understood to have offered Macao back to China after the 1974 coup but was asked to wait. *Indonesia invaded East* Timor in 1975, after the Portuguese colonial administration withdrew amid civil strife, and later annexed the territory.

Portugal, still recognised by the United Nations as the administering power, has been at the forefront of efforts to win self-determination for the East Timorese and end human rights abuses by the Indonesian military.

But Indonesia used Portugal's abandoning of East Timor to "anarchy and ruin" to justify its invasion and has accused Portugal of exacerbating problems in the territory by failing "to show a clear political will to reach a solution".

"For us, there is no more East Timor problem, internally," Ali Alatas, Indonesia's foreign minister, said. "But externally, we have to admit the problem is still there, because Portugal makes it a problem."

Indonesians complain of East Timorese "ingratitude" *for wanting to secede. "If it* was up to me I'd get rid of East Timor tomorrow," one official said. "It's such a headache."

No one in Jakarta talks about the graves the Indonesians will leave behind. Human rights organisations estimate that over 200,000 people have died, from a population of 650,000 at the time of the invasion, because of abuses by the military, guerrilla warfare, starvation and disease during 24 years of Indonesian occupation.

Kept in the dark about army abuses by a censored press, few Indonesians are aware of the extent to which East Timorese resent their occupation.

Diplomats say the sudden change of tack by Indonesia over East Timor's future is more a reaction to foreign pressure than to an awareness of the intractable nature of the problem.

Portugal's main concern in Asia is to bring its empire to a close without the trauma that marked its withdrawal from other overseas possessions.

"We have had so many more years to prepare for the return of Macao than we had to handle de-colonisation in Africa," said a government official. "If things go badly, we have only ourselves to blame."

Wang Yingfan, China's vice- foreign minister, said the handover would bring a "new dynamism" to Sino-Portugese relations and that Macao would act as a "bridge" between Portugal and the European Union.

But he acknowledged unspecified areas of tension between Lisbon and Beijing. These include, above all, security.

Increasing gang violence has chased away Macao's main sources of revenue: *tourists and gamblers. Its* economic woes include rising unemployment, a falling property market and mothballed infrastructure projects.

The transition in Macao, like Portugal's withdrawal from Africa, will again lead to an exodus. Portugal, a relatively poor country of less than 10m, successfully absorbed about 750,000 settlers who fled from Angola and Mozambique in 1975.

Almost all the Eurasian population of Macao, known as Macanese and estimated at about 3 per cent of the population of 425,000, are expected to leave before China resumes control.

■ *Reporting by Peter Wise in Lisbon, Sander Thoenes in Jakarta and Louise Lucas in Hong Kong*

China's budget 'supervised'

By James Kynge in Beijing

China's National People's Congress, or parliament, has established a sub-committee to "supervise" the draft budget before it is adopted at the annual full session of the NPC which this year starts in March.

The move is not expected to have much more than a symbolic importance this year but the establishment of such a committee is one of several signs that China's leaders are serious about upgrading the role of the NPC, which has often been maligned as a "rubber-stamp" forum for Communist party directives.

The sub-committee will be headed by Guo Zhenqian, who is one of six vice-chairmen in the NPC's financial and economic committee.

"Past examinations of the budget have been mostly procedural, and the new organisation will make the supervisory action more substantial," the official Xinhua news agency said.

Li Peng, chairman of the NPC, has been keen to enhance the body's role, and recently called upon NPC delegates to start supervising the work of local law courts. To illustrate his point he dropped in "unexpectedly" to listen to a trial in the southern province of Fujian recently.

Under the constitution, the NPC is supposed to supervise the work of the Supreme People's Court and Supreme People's Procuratorate, but in practice it has rarely concerned itself with day-to-day legal cases.

Jakarta lowers targets on troubled banks

By Sander Thoenes in Jakarta

Indonesia's parliament is expected today to clear the way for a combination of closures and recapitalisations of troubled banks, but the government is lowering its own tough targets and will opt to nationalise some instead tomorrow.

Parliamentary factions agreed earlier this week on the state budget for the fiscal year that starts April 1, including an Rp17,000bn ($1.9bn) allotment for payment of interest on government bonds that are to be injected into banks at risk of going illiquid. Analysts had expected some 30 banks would be closed tomorrow and up to 70 listed for recapitalisation, but in a last-minute change of policy, central bank officials introduced nationalisation as an alternative.

Recapitalisation of the banking sector is needed to compensate for collapsing loan portfolios and a negative spread on interest – *banks borrowing at higher* rates than they receive. This has left many banks unable to lend or meet trade obligations, putting a severe drain on the real sector.

The budget approval enables the government to calculate how much interest it can pay on the bonds and how much it can spend on liquidation of sick banks, which is costly as it earlier guaranteed all deposits and other liabilities. Nationalisation, analysts suggest, would mean little more than delaying a decision on some of the many banks that lack cash to inject their 20 per cent share of the recapitalisation.

"I think a lot of compromises will be made," one western banker said. "The doubtful cases will be given some more time."

Tomorrow's announcement will end months of deadlock that has left banks bleeding and therefore raised the cost of a bail-out to the point where many banking experts estimate that the Rp253,000bn the government expects to spend will fall far *short of what is needed.*

"It will probably cost about Rp400,000bn by the time they get around to it," said Liny Halim, banking analyst with ING Barings. "But the more they delay the recapitalisation, the more costly it will be."

In theory, only banks with capital adequacy ratios between minus 25 per cent and plus 4 per cent are eligible for recapitalisation – if they present a credible business plan, deposit their 20 per cent share of the capital injection, pay back central bank loans and retrieve loans improperly issued to affiliated parties.

The interest rate on the bonds needs to be competitive with central bank paper rates, stubbornly high at 37 per cent, for banks to be able to sell them and thereby improve cash flow. The government expects to spend Rp34,000bn on bond interest and bank liquidation in the coming fiscal year, of which Rp17,000bn will come from the budget, but analysts say that would allow for rates of less than 25 per cent.

Hanoi to let dong depreciate

By Jonathan Birchall in Hanoi

Vietnam is to let its non-convertible currency, the dong, depreciate daily by up to 0.1 per cent against the US dollar, it was announced in Hanoi yesterday.

If the state bank chooses not to intervene, the move could in theory let the dong depreciate against the dollar by some 25 per cent over the next 12 months.

The bank had formerly been following a strategy of stepped devaluations; three such reductions in the official rate since June 1997 have brought the value of the dong down by about 18 per cent against the dollar, with the last such devaluation in August.

But the dong has still appreciated by about 25 per cent over the same period against other South-east Asian currencies, raising concerns over Vietnam's longer-term competitiveness as exporter and destination for foreign investment.

The Vietnamese central bank has been seeking to avoid sudden devaluations which could further erode public confidence in the currency and the country's banking system.

Despite the pattern of depreciation against the dollar, retail black market rates are currently near those officially available in the banks.

The new system will let the dong trade against the dollar on the interbank market in a band of plus or minus 0.1 per cent of the official daily target rate set by the central bank.

The target rate for each day will be set by the prevailing interbank rate from the previous day, in effect letting the dong depreciate *0.1 per cent daily.*

Singapore growth at 1.5%

By Sheila McNulty in Kuala Lumpur

Singapore's gross domestic product grew 1.5 per cent in 1998 over the previous year in what economists said was a very mild slowdown relative to the region, which remains gripped by economic crisis.

Finian Tan, deputy secretary of the Ministry of Trade and Industry, said it was too early to declare that the economy was recovering. The ministry said in announcing the data that it expected 1999 GDP between minus 1 to plus 1 per cent.

The 1998 figure was within expectations and economists noted it was far better in Singapore's previous recession, when minus 1.6 per cent GDP was reported in 1985.

"It's the best in emerging Asia – except for Taiwan – among the smaller countries," said Neil Saker, head of economic research at SG Securities in Singapore. But Kostas Panagiotou, senior economist at Kim Eng Securities in Singapore, said some of the domestic demand components of GDP fell by amounts comparable with those of the 1985-86 recession.

In the fourth quarter of 1998, domestic spending declined by 14.7 per cent year-on-year, driven by a 21.8 per cent year-on-year fall in investment and a 3.2 per cent year-on-year fall in private consumption spending. Some investment categories, such as transport equipment, fell by as much as 46.4 per cent year-on-year.

De-stocking intensified during the quarter, with falling inventories subtracting 5.9 per centage points from GDP growth.

Iran's reformers put their hopes in the votes of women and the young

Today's local elections will be a test of public support for President Khatami's battle against the clerical establishment. Robin Allen reports

Iranian President Mohammad Khatami's government is trying to galvanise support from women voters and some 15m young Iranians to win strong endorsement of its reformist policies when the country votes today in the first-ever nationwide local elections.

About half the 63m population is eligible to vote. Two-thirds of these are women and voters under 30. Iranians qualify to vote when they enter their 16th year.

Today's elections will be the most important test of public opinion since Mr Khatami was swept into office in a landslide mandate for political and social change two years ago by more than 70 per cent of voters on a turnout of more than 90 per cent.

Ranged against the reformists are the conservatives who form the largest group in the majlis (parliament), and hardline secular and clerical vested interests who control most of the constitutional levers of power.

These include the clerical-dominated judiciary, state radio and television, the security and armed forces, vital unelected bodies such as the *Council of Guardians* and election supervisory boards, as well as the network of mosques and religious and state foundations across the country.

According to the interior ministry 327,000 candidates, of whom 5,000 are reckoned to be women, had registered by last Sunday's deadline, to contest about 200,000 local council seats. In the fiercest contest, in the capital, Tehran, 4,200 candidates are competing for 15 council seats]

Elected councillors will be responsible for appointing 720 mayors and starting the process of widening public participation in local social, economic, and political issues, which until now have been controlled from Tehran's centralised and conservative bureaucracy.

According to Bijan Khajehpour, editor of the monthly Iran Focus, the establishment of local councils, notably their power to raise local taxes, represents a first step of the government's plans to devolve fiscal and administrative power away from Tehran. This in turn would lead to *the process of privatising the* state entities that dominate Iran's economy and generate 85 per cent of the country's gross domestic product.

Mr Khatami was little known when, in 1995, the conservative-dominated parliament passed legislation allowing local elections to take place.

They did not at that time foresee any threat to their national power structure, which rested on a tripod of provincial governors, the majlis deputy, and the mosque, notably the Friday prayer leaders.

But with the formation of Mr Khatami's administration in August 1997, and in particular the arrival of Abdollah Nouri as Mr Khatami's first interior minister, all this changed.

Before his impeachment by the majlis last June, Mr Nouri had weakened the entire tripod by replacing all provincial governors with nominees more responsive to the national mood for reform, and by instructing their successors to undermine the influence of conservative deputies and the more obscurantist prayer leaders.

His successor, Moussavi Lari, has continued the process.

The conservatives have fought back. First, they used control of state radio and television to ensure the government's message of the importance of the elections did not get through, notably to rural areas where people are more conservative anyway.

Second, supervision councils, appointed by the majlis, tried to weed out *reformist* candidates, particularly women, who they claimed did not demonstrate sufficient "practical belief" in Islam and in orthodox interpretation of the Islamic constitution. But government supporters responded. Sixteen different organisations of reformists, technocrats, leftwing and student organisations formed an alliance for the elections. Last month the conservatives were forced to accept a compromise "arbitration panel" to take over the vetting of candidates; a compromise they have since made every effort to ignore.

This week a bitter dispute erupted in Tehran after conservatives tried to bar a dozen leading reformists from competing for some of Tehran's city council seats.

The conservatives' rearguard action, however, has taken its toll. The number of candidates has fallen far short of the interior ministry's hopes, and "the whole electoral exercise", according to Safa Haeri, a Paris-based expert on Iran, "remains unknown to large segments of the public. Mr Khatami has not had enough time and his message has not been getting through."

The central question, however, according to Mr Khajehpour, is not which faction, reformist or conservative, wins the elections, but how financially independent future councils will be; and how, once estab*lished as new fixtures* on an ancient body politic, they will fit into the country's complex and opaque power structure.

Most analysts agree that for all the sniping, the conservative opposition cannot put back the clock. Mr Khatami, in his 18 months of office, has already brought about a sea-change in Iranian attitudes and expectations, particularly among the young who never knew life under the Shah before 1979 and are neither enthused nor intimidated by the dogma of the hardliners.

For all his constitutional weakness, Mr Khatami by contrast, has a vision for his country to which the young can relate and in which they have put their hopes.

ELECTION FEVER An Iranian studies posters for Tehran city council elections due to take place today. Battle lines are drawn between conservatives and reformists Reuters

Nigeria seeks UK backing in debt talks

By Michael Holman, Africa Editor

Ismaila Usman, Nigeria's finance minister, yesterday sought Britain's backing for "substantial and highly concessional relief" on the country's estimated $29bn external debt.

Speaking at a conference in London organised by the UK Department of Trade and Industry, the minister said the debt "constituted a huge burden for the country, particularly in the face of dwindling revenue owing to the depressed international crude oil market".

Mr Usman, who was due to meet Gordon Brown, chancellor of the exchequer, yesterday, appealed to the UK government "to use its tremendous goodwill and influence to assist Nigeria".

Mr Usman told the conference there was "an urgent need for an understanding to be reached" with the Paris Club of official creditors. He said he expected a formal meeting "towards the end of April or some time in May".

Two thirds of Nigeria's external debt is owed to the Paris Club, including arrears of more than $16bn. Britain is owed at least $5bn.

The minister said he hoped the recent agreement on an IMF-monitored programme would be followed by an extended structural adjustment facility "before the end of the first half of 1999". The three-year loan is expected to be at least $1bn.

Mr Usman also said the World Bank was convening an informal donors meeting for Nigeria in mid-March. Nigeria needs financial, technical, and other assistance in sectors such as water supply, health, education and infrastructural developments, he said.

Speaking at the same conference, Brian Wilson, British trade minister, emphasised Britain's "determination to help Nigeria push the transition (to civilian rule) through successfully".

But he made clear that this depended on further reform, "especially on transparency and corruption".

If Nigeria was to improve relations with the Paris Club, he said, the government would have to establish "a track record and improved macroeconomic policy under an IMF programme".

It was particularly important, added Mr Wilson, for Nigeria to "tackle all categories of arrears to Paris Club creditors ... (and demonstrate) comparability of treatment amongst creditors".

Britain was also "eagerly awaiting" more details on the privatisation programme.

Although the minister welcomed the release of political detainees by the military government, there was "obviously more to be done", he said, noting that a number of military personnel were still being held in connection with alleged coup plots in 1995 and 1998.

Harare editors stand firm

Editors of leading independent newspapers in Zimbabwe said yesterday they would resist any government attempt to muzzle the press, which President Robert Mugabe accuses of smearing and undermining his administration, Reuters reports from Harare.

After Willard Chiwewe, the information secretary, told the press "to behave responsibly and in a patriotic manner" in their reporting, the editors said they would do their job professionally.

Four editors were summoned by Mr Chiwewe on Tuesday to discuss the government's grievances with the private media.

They said they told the information secretary it was wrong for government officials or government editors to call the private press editors enemies of the state for simply doing their professional job.

"We made it clear to him, and we wish to restate, that we will continue to discharge our professional duties without fear or favour, as we have been doing," they said.

Mr Mugabe has launched a campaign against Zimbabwe's generally critical private press, accusing it of trashing his record and of conspiring with sections of the foreign press, some western governments and Zimbabwe's former white rulers to destabilise his 19-year-old government.

The press is focused on Mr Mugabe's handling of an economic crisis, his poor relations with donors and his government's attack on civil liberties, including the banning of strikes and the recent detention and alleged torture of two journalists by the army over a story alleging a coup plot.

The four editors said they were driven by a high sense of patriotism in campaigning for good governance and that some ministers felt they were doing an excellent job.

"We regard issues of corruption, abuse of human rights, observance of the rule of law, transparency and accountability to be crucial issues in Zimbabwe," they said in their statement, condemning the ministry of information for remaining silent over the alleged abduction and torture of journalists.

CAR MANUFACTURING ROVER 200 AND 400 TO BE REPLACED

New model for BMW offshoot

By John Griffiths in London

BMW is expected to announce early next month that it will go ahead with a $2.7bn project to replace Rover's 200 and 400 models. But the German group will avoid committing to build the new models at the Longbridge plant near Birmingham in the English Midlands.

The announcement – likely to come at the Geneva Motor Show – will signal the start of negotiations with the UK government in which BMW is seeking £150m-£200m of public aid for the plant.

BMW will tell ministers the project could be located more profitably in Hungary or other sites outside the European Union if they fail to back the request for financial aid, according to people close to the negotiations.

But people in the car company say that Longbridge, whose 14,000 workers build the current Rover models, is the preferred site.

Under EU state aid rules it is necessary to show a real possibility that a project would locate outside the EU unless assistance were given.

Stephen Byers, the chief UK industry minister, yesterday stressed that the government will treat any application sympathetically. It would do "all it can financially" to ensure Longbridge builds the new car range. "I am confident that Longbridge is in a strong position," said Mr Byers.

BMW has been considering whether to introduce a small BMW, to be called the 2-Series. This would share a body platform with the 200/400 replacements to make the project more viable.

But Joachim Milberg, the new BMW chairman who succeeded the ousted Bernd Pischetsrieder after a boardroom dispute over the future of Rover this month, has ruled out this option.

The 200/400 replacements, scheduled for introduction in 2002, will consist instead of a much broader range of vehicles. They will include multi-purpose vehicle variants, according to people associated with the project.

Production of up to 500,000 units a year is envisaged, double Longbridge's current output of 200/400 models.

● General Motors' Vauxhall subsidiary is to set up GM's first development engineering activity in the UK for more than a decade.

The £5m centre, employing 75 engineering staff, will be involved in the engineering of light commercial and recreational vehicles, including work on a new range of panel van being developed jointly with Renault.

While Vauxhall has car and engine assembly plants in the UK, it has had no development engineering activities in the UK since GM sold Bedford, its truck company, in 1986. Car development was taken over by GM's Opel subsidiary in Germany 20 years ago.

Audi to invest $80m in Cosworth engineering group

A big expansion was announced yesterday for Cosworth Technology, the UK automotive engineering consultancy, John Griffiths writes. Cosworth was bought by Volkswagen's Audi subsidiary from Vickers of the UK in September 1998 for an estimated £70m ($114m). Audi, VW's executive cars division, is to provide £47m of new business to Cosworth over the next three years and invest more than £50m in its infrastructure and facilities. The effect will be almost to double employment to 1,500 over the next three years. The extra jobs will be mainly at Cosworth's three plants in the English Midlands although its US subsidiary in Novi, Michigan, will also benefit. Cosworth's racing engine division was sold by Audi to Ford soon after completing the deal with Vickers. Cosworth has had a close motor sport relationship with Ford for more than 30 years.

RETAILING BIRMINGHAM INITIATIVE

Developers drop rivalry to boost revamp of city

By Juliette Jowit in Birmingham

Two of the UK's biggest retail development rivals yesterday joined forces to launch what they claim is the biggest city centre shopping scheme in Europe.

Hammersons and Land Securities – together with Henderson Investors – said they would pool their two developments in Birmingham, the second biggest city in the UK, into a single 240,000 sq m project with more than 200 shops. Work will start in about a year and the project will cost £800m ($1.3bn).

The development of the notoriously ugly Bull Ring complex in the city centre, owned by Hammersons, and Martineaux Galleries, owned by Land Securities and Henderson, will be taken over by three new joint venture companies.

Ronald Spinney, chief executive of Hammersons, said the projects would create 8,000 jobs and mark the final phase of the city's 10-year regeneration. "It's going to define the city of Birmingham and consolidate its position as one of Europe's most exciting urban destinations," he said.

The developer's move is widely seen as the only way forward. Both schemes have found it hard to attract retailers, who were playing off one rival against another. Hammersons signed up Debenhams, Boots and Marks and Spencer. The other project had no tenants. The alliance is now believed to be talking to household names including Selfridges.

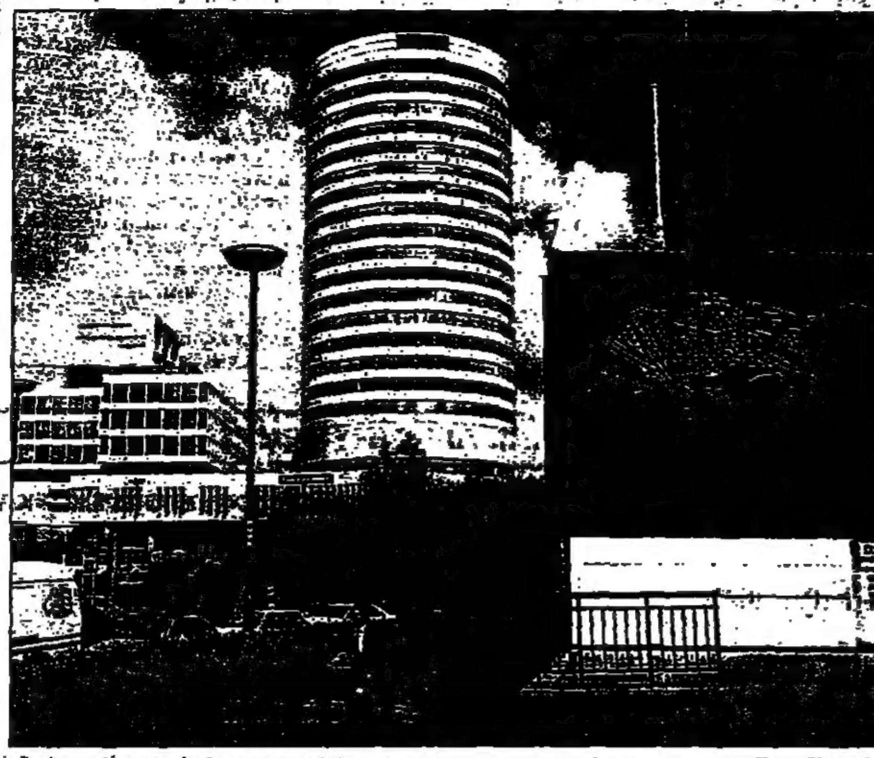
Mr Spinney denied Hammersons was bounced into the deal but admitted the collaboration of two rivals on such a big project was "unique".

There was relief in Birmingham that the development would go ahead. It is the UK's second city with a population of 7m within a one-hour drive.

Demands from retailers pushed rents up 40 per cent last year and the current range of shops is seen as low quality. Competition from nearby centres and out of town malls has been rising.

Teresa Stewart, leader of Birmingham's municipal authority, said it was the last big improvement needed to overcome the city's poor image, following the success of the International Convention Centre and National Exhibition Centre. "It's a strategy of cutting through the concrete jungle of the 60s and 70s to deliver an attractive look for residents and visitors," she said.

● The Court of Appeal in London yesterday reserved judgment on an effort by local and environmental protesters to block the construction of the Birmingham northern relief road, which would be Britain's first tolled motorway.



On its way out: the unloved Bull Ring complex in the centre of Birmingham — News Team Birmingham

Stakeholder report given cautious welcome

By Jane Martinson and Jim Kelly

The City of London yesterday gave a mixed response to a report aimed at achieving a complete overhaul of the way companies do business.

Key chapters of the report focus on the company's relationship with the wider community and its shareholders and stresses the need to remove the burden of legislation from smaller companies, as reported in the Financial Times yesterday. The 214-page report also says there is a need to increase the use of technology among UK companies for better communications and to find some method of perpetually updating corporate law.

In launching the consultation document, Sir Stuart Hampson, chairman of John Lewis and a member of the 12-strong committee, said it hoped to go "to the heart of something referred to as the stakeholder debate".

He said that existing company law places an obligation on directors to take account of other important groups but that this might need to be clarified.

He called for a broad response before the committee publishes its preliminary findings before the end of the year.

Few large City of London law firms had officially responded to the review following its launch by the Department of Trade and Industry last May.

Richard Regan, head of investment affairs at the Association of British Insurers, which represents large institutional investors, said: "We note that the question of stakeholder interests is back on the agenda. However, it is important to recognise that directors are accountable to shareholders while we acknowledge that they have a responsibility to others."

However, Philip Goldenberg, senior lawyer at SJ Berwin, said the arguments about pluralism in the report were largely there to be rejected, although he welcomed the suggestion of the Law Commission that directors agree to a "highway code of conduct".

Mark Goyder, director of the Centre for Tomorrow's Company, said that reform of the Takeover Code was required to bring about an efficient stakeholder regime because it promoted short-term consideration of the interests of shareholders.

Roger Davis, head of professional affairs at PwC, the financial services company, said: "This is a once-in-a-generation opportunity [illegible] accountants and auditors to rethink the profession."

Money launderer gets $1.6m fine and 14 years' jail

PA News Reporters in London

A businessman who used a bureau de change as a front for Europe's biggest money laundering operation was jailed for a maximum 14 years and fined £1m ($1.6m) by a London judge yesterday.

The court heard that Jerusalem-born Ussama El-Kurd maintained a modest lifestyle and premises, enabling him to cultivate an image of a man barely making a living converting tourists' spending money.

But an estimated £70m passed through his hands in a secret counting house in the basement of the west London bureau in just under two and a half years. The cash belonged to British criminals.

Mr El-Kurd – a 50-year-old father of five from Greenford, west London – was convicted on Wednesday, after a five and a half month trial, on four money laundering conspiracy charges between 1994 and 1996.

The judge told him that "knowing or suspecting that those with whom you were dealing were introducing the proceeds of criminal activity on a massive scale to your business, you not only willingly assisted one and all to do so, but seized the opportunity avariciously to enrich yourself to a fabulous extent as a result".

[illegible] middleman and courier, skipped bail nearly two weeks ago and received a 10 year sentence in his absence. In just over a year he ferried at least £10m from crime gangs in north-west England to Mr El-Kurd's base in the capital's Notting Hill district.

"I am satisfied that the immense sums of money which passed through the Notting Hill exchange were utilised to facilitate future criminal conduct as well as to enable those who had already perpetrated the elicit activity to enjoy the fruits of it," said the judge.

He told Mr El-Kurd it was clear this cash was from "very substantial" criminal activities and that the "major responsibility" for it rested squarely with him. "I regard your involvement ... as meriting punishment at the very top of the scale," he said.

The case involved low value sterling notes exchanged for high value foreign ones – principally guilders, D-Marks, pesetas and Swiss francs – from a Thomas Cook travel agency, as well as branches of Barclays and Arab Bank.

The judge said that "not guilty" verdicts clearing Mr El-Kurd and Mr McGuinness, of Dovecote, Liverpool, of specifically laundering drug [illegible] would remain uncertain how the cash had been generated.

Tougher targets to be imposed on rail companies

By Charles Batchelor, Transport Correspondent

The government yesterday set out its detailed plans for improving the privatised rail network, promising continued pressure on poorly performing companies and opportunities for the best.

"Delivering on our promises on transport is as important to the government as delivering on its promises in all our key areas like health and education," Tony Blair, the prime minister, told a rail industry "summit" in London.

The government's proposals for tougher performance standards and the renegotiation of train operators franchises represent the biggest shake-up of the railway industry since privatisation was completed two years ago. Overall responsibility for rail planning will be assumed by a "shadow" strategic rail authority which will begin work on April 1. Sir Alastair Morton – former chairman of Eurotunnel, operator of the Channel tunnel between France and England – was appointed chairman of the authority on Wednesday.

John Prescott, deputy prime minister and chief transport minister, described the programme unveiled to 180 senior rail managers and passenger representatives as "a spring-clean package". He added that it would replace regulations that were "confused and weak and often contradictory".

He warned that there would be no relaxation of pressure on the rail companies to perform and they would be expected to report on progress to a follow-up meeting in a year. But Mr Prescott acknowledged that the railways' problems could not be solved in the short-term. "The first 12 months, the next three years and the next 10 years are stations on the way to the modernised railway," he said.

Mr Blair said he wanted to make perfectly clear that the rail companies were still "on trial" over performance. But he softened the government's previous hard-line stance by paying tribute "to those in the industry who are getting results".

Christopher Garnett, chief executive of Great North Eastern Railway, pledged that the operators would improve their performance over the next 12 months.

Sir Alastair said the strategic rail authority would not revert to the "command and control" approach applied by British Rail when it was in the public sector. "The authority's mission is to plan, negotiate and facilitate," he said.

NEWS DIGEST

GOVERNMENT OUTSOURCING

Lockheed Martin wins $81m contract for UK census

Lockheed Martin has won a £50m ($81m) contract to modernise the UK census in time for the next one in 2001, which will require the processing of 30m forms. The contract was awarded by the government's Office for National Statistics. Lockheed Martin will sub-contract the processing to the ICL computer services offshoot of Fujitsu and the printing to Polestar Group, one of Europe's biggest printing companies. The same technology will be used in the US census in 2000. Tim Holt, ONS director and registrar general for England and Wales, described the techniques, said to be more accurate than manual keying, as "the best the world can offer".

Art Johnson, president and chief operation officer of Lockheed Martin's information and services sector, said: "This is a significant commercial information technology effort and it emphasises our long-term commitment to expand still further our many partnerships with the British Government and industry." **Simon Briscoe, London**

PREVENTION OF TERRORISM ACT

Sinn Féin attacks detentions

Sinn Féin, the political wing of the Irish Republican Army, protested yesterday at the holding by police in England of three former Irish republican prisoners detained under the UK's Prevention of Terrorism Act. Pat Coyle, Sean McMonagle and Tony Miller will be detained for a further 24 hours following their arrest at Manchester airport, in Northern England, on Tuesday. Permission to hold the men was given by Jack Straw, the home secretary.

Mary Nelis, a Sinn Féin assembly member for the Northern Ireland city of Londonderry, said the men's detention was a "glaring example of the abuse of civil and human rights which accompanies the act; thousands of Irish people are detained and questioned under this repressive legislation every year, yet the statistics will prove that only a fraction of these people have ever been charged with any offence, or are subsequently convicted".

THE ECONOMY

Employers predict jobless rise

[illegible] is set to rise by almost 400,000 over the next two years, even if interest rates continue to fall sharply, the Confederation of British Industry, the employers' lobby, said yesterday. It identified "glimmers of hope" for manufacturers in its latest monthly industrial trends survey but believes they are probably too late to stop the economy stalling over the coming six months. "There's qualified good and bad news," said Sudhir Junankar, the CBI's associate director of economic analysis. "We expect the economy to be at a stand-still, but to pick up in the second half, and more so in 2000," he said. Fewer manufacturers reported orders below normal this month than in January.

"From our regional meetings, we have anecdotal evidence that orders are already starting to come back from France and Germany," said Kate Barker, CBI chief economic adviser. **Melanie Carroll, London**

SECRET INTELLIGENCE SERVICE

Career spy to head MI6

A career spy was yesterday named by the Foreign Office as the new head of the British secret intelligence service, popularly known as MI6. Richard Dearlove, the service's assistant chief and director of operations, will take over from Sir David Spedding when he retires in September. Mr Dearlove, 54, joined SIS in 1966 and was posted under diplomatic cover to Nairobi, Prague, Paris, Geneva and Washington. In 1993, he became SIS's director of personnel and administration before being made director of operations a year later.

The Foreign Office said: "Mr Dearlove's broad-ranging operational career has given him particular experience of working closely with national and international intelligence, security and law enforcement agencies." Tom King, the chairman of the parliamentary intelligence and security committee, welcomed Mr Dearlove's appointment. "We have considerable respect for him," he said. **Jimmy Burns, London**

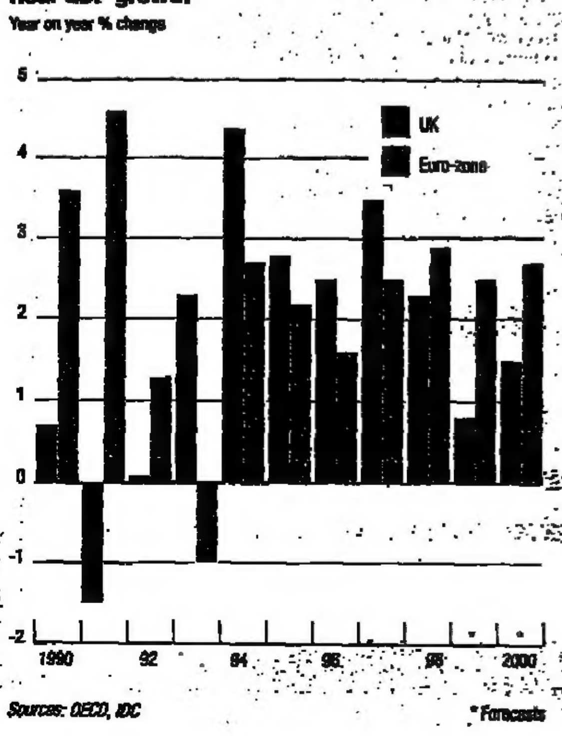
RACE MURDER

Parents seek compensation

The parents of Stephen Lawrence, the black student murdered by white youths in London six years ago, yesterday announced they will sue the Metropolitan Police over its handling of the investigation, unless they are paid adequate compensation. The move was made on the same morning that vandals attacked the memorial plaque to Mr Lawrence, set in the pavement at the site of his death. Jack Straw, the home secretary, described the desecration as "a dreadful act". Mr Lawrence's parents said it justified their decision to bury their son in Jamaica.

A day of fast-moving events following the publication of Sir William MacPherson's report into the killing of the black teenager began when the Daily Mirror newspaper offered a reward of up to £50,000 for any information leading to the conviction of any of the five prime suspects. Meanwhile, Sir Paul Condon – Metropolitan Police Commissioner, the London police chief – insisted that the murderers should still "feel hunted" and pledged to do all in his power to bring them to justice. *Simon Buckby, London*

Many uncertainties hang over nation's route towards euro



Sources: OECD, IDC — *Forecasts

Is the UK economy ready for membership of the single currency? Christopher Adams and Richard Adams report

This week the UK government signaled its strongest commitment to eventual membership of the European single currency. But is the economy ready for it?

Tony Blair, the prime minister, made clear there was a strong likelihood the relevant economic conditions for joining would be in place shortly after the next national election, due in 2001 or 2002.

But judging how close the UK is to convergence is not easy.

Paul Turnbull, UK economist at Merrill Lynch investment bank, says the government's tests for entry are sufficiently vague for political expediency to dictate whether or not they have been met.

They ask whether there can be sustainable convergence between the UK and the euro-zone economies; if there is adequate flexibility to cope with economic change; what effect there might be on investment; what will be any impact on financial services; and whether participation would be good for employment.

Mr Turnbull believes the biggest obstacle to Emu membership will be public opinion.

"This constitutes a barrier to entry that did not exist, at least in the immediate run-up to Emu, for any of the founder members of the euro," he says.

But some analysts argue there are considerable economic uncertainties. Most important, a rebound in growth next year could create inflationary momentum that would require some tightening of monetary policy, lifting UK interest rates away from euro-zone levels.

The likelihood of this increases if the Bank of England, the UK central bank, adopts a more activist stance towards monetary policy. Monetary policy could be eased further in the short term, with interest rates perhaps moving from 5.5 per cent to between 4 and 5 per cent.

Eddie George, Bank governor, said this week there was "potential for conflict" should pressure grow for interest rate convergence. The Bank might find it difficult to meet the inflation target if it was obliged to reduce rates towards European levels.

Inflation remains one of the UK's weaknesses and there is much to do to bring the rate of general price increases down to the euro-zone level.

David Mackie, UK economist at JP Morgan investment bank, says inflation is likely to go much lower than the Bank of England or many independent analysts expect, creating opportunistic disinflation". Mr Mackie adds: "If, for whatever reason, inflation unexpectedly shifts lower, the central bank should take advantage of the situation by lowering its policy objective."

The UK's inflation rate, as measured by the pan-European Union Harmonised Index of Consumer Prices, is 1.6 per cent at an annual rate. The average for the euro-zone is 0.8 per cent.

The UK's price inflation under the HICP measure has been 0.6 per cent lower over the past five years than the standard headline retail prices index measure.

So it seems UK inflation, measured by the HICP, is in line with the European Central Bank's target for harmonised inflation of between zero and 2 per cent. But the Bank of England's monetary policy committee has a clear policy objective – it is charged by the government with keeping the underlying price index to 2.5 per cent. But Mr Mackie says it is "not entirely evident" what the ECB is trying to achieve. "The ECB's behaviour in the past couple of months – it has shown little inclination to cut rates despite sluggish growth, inflation 0.8 per cent and unemployment at 10.8 per cent – suggests it is aiming to keep inflation below 2 per cent at all times," he argues.

That implies the ECB is aiming for an average inflation rate of about 1 per cent – in which case the UK inflation target will need to be reduced well ahead of Emu membership.

Mr George made a similar point to the House of Commons Treasury committee on Tuesday. Mr George said he had not discussed with the chancellor of the exchequer what policy action needed to be taken ahead of Emu membership. But he warned that a change in the measure of inflation would mean an adjustment to the target.

RICHARD DONKIN

Riches for the few

Share incentives are widening the pay gap between the top and the bottom

For a few years during the 1990s it looked like companies were becoming interested in the single status workplace. The management dining room, the named car park space and the key to the directors' loo seemed things of the past as companies began to flatten their hierarchies.

These symbols of power began to look out of place as companies reduced staff levels and took on the outward appearance of a meritocracy. Management no longer used the language of "us and them", just "us", and it referred to everyone.

A few cases of cynicism remained, secretly identifying with a cartoon called Dilbert, particularly when it was explained that the "common good" amounted to faceless shareholders whose outlook did not extend far beyond the next profit and loss account. But this was the system. Surely it was the same for everybody.

Alas it never was the same and the differences in the reward structures of those at the top and those at the bottom are becoming increasingly apparent. The language of "us and them" is alive and kicking in one area that really matters to the individual – the pay deal. Instead of a common pay system worked out by the head of human resources, publicly quoted companies favour a two-tier system.

Pay consultants tend to work most strenuously at the top end of the company, devising elaborate packages of incentive and reward like Savile Row tailors creating bespoke suits, while the mass of employees get an off-the-peg deal.

A top UK executive can earn 20 times more than a clerk

The fanciest of these packages in the UK tend to be the *high-octane pay deals* devised for US executives recruited to run UK companies. The bonus and incentive-weighted pay package conceived for Michael O'Neill, the new chief executive of Barclays, recruited from Bank of America, is the latest deal to raise concerns that transatlantic executive recruitment is leading to escalating rewards for UK chief executives.

Barclays had to splash out £10m to bring in Mr O'Neill, but less than 10 per cent of that figure is base pay. He will get £850,000 base salary plus 105 per cent bonus in his first year, in addition to a share option package worth four times his base salary and an unusual trust incentive that will further boost his earnings if he stays for at least three years.

The long-term incentive requires him to buy £5m worth of Barclays shares and place them in trust. The bank will match the portfolio with another £5m of shares which will be passed over to Mr O'Neill if he stays in the post.

Companies, it would appear, need not fear UK government proposals to put *company remuneration* policies to a vote of shareholders. Barclays shareholders regarded Mr O'Neill's appointment as money well-spent. Barclays shares rose 76p after the announcement. The company then announced a freeze on costs.

The extent to which base pay has been reduced to the status of pocket money in US-style executive packages was highlighted in a recent paper by Brian Hall, an associate professor at Harvard Business School. His analysis of executive pay between 1980s and 1994 in 478 large US companies found that changes in a chief executive's wealth due to share and share option revaluations were more than 50 times larger than the changes in their wealth due to salary and bonus.

An average chief executive, whose company increased in value by 10 per cent, says Prof Hall, would have seen his salary and bonus increase by $23,000 (£14,110), but the value of his shares and share options would have risen by $1.25m. "Salary and bonus changes thus account for only 2 per cent of pay-to performance sensitivity, while stock and stock option changes account for the rest," he says.

Prof Hall suggests some refinements to the way options should be paid. But he makes no observations about the underlying fairness of the system. Rather he points out that the idea of building large equity stakes among chief executives is to encourage them to "think like owners".

Their thinking these days so often seems to move in the direction of merger, resulting in yet another weeding out exercise among the workforce.

Merger-related job cuts were twice as high in 1998 as they were in 1997 in the US. These are not all in the lower ranks. Challenger, Gray & Christmas, a US outplacement business, points to evidence of increasing numbers of higher paid executives losing their jobs. "Companies are clearly focusing on limiting higher paid jobs in an effort to reel in costs," says John Challenger, its chief executive.

This gives the lie to the "employees as assets" myth. Employees are often a company's biggest cost. Redundancies and recruitment are also costly so the modern human resource specialist will seek to increase agency labour and temporary employees in addition to outsourcing.

Meanwhile the gap between the earnings of those at the top – whose packages are so loaded with variable pay arrangements it is difficult to estimate their actual returns – is increasing. A top executive in the UK today can expect to earn between 20 and 25 times the earnings of a junior clerk, according to calculations made by Hay Management Consultants. In the US the differential is 40 to 50 times, in Germany 15 to 20 times and *in Japan 10 to 15 times*.

Sir Stuart Hampson, chairman of John Lewis Partnership, has been a lone voice in what otherwise seems like a conspiracy of silence about pay at the top. He believes that the difference between top and bottom pay should become a prominent issue in corporate governance. "The concept of a relationship between what a sales assistant is paid and what a director is paid is important," he told delegates at a recent conference on employee share ownership. "It's absolutely at the heart of fairness that there should be some link between pay at the top and pay at the bottom."

If UK public companies are to become true meritocracies they must do more than emulate US-style executive packages for their directors. They should introduce equity stakes – far more prominent in US businesses – for all employees. At Capital One, the fast-expanding US credit card company, every employee received 200 shares about four years ago when they were worth $19 each. Those shares are now worth more than $20,000. "It's enough for some of our people to buy a house for the first time in their life. That really makes a difference," says Nigel Morris, Capital One's president.

No wonder many of the more entrepreneurial fledgling companies are attracting some of the most talented young people. A *new generation of employees* is voting with its feet.

richard.donkin@ft.com

WORKING BRIEFS

How time off can translate into lifelong learning

If anything highlights the different cultures of the US and UK workforces it is their respective attitudes to time off. Americans seem almost ambivalent about time off, yet in the UK people leap at the opportunity to get away from work.

There is something seductive, therefore, about a report entitled *Time Off Pays Off – How Reductions in Working Time Can Create Jobs and Promote Lifelong Learning Opportunities*. The Fabian Society paper makes a well-argued case for establishing a right to time out of work for learning new skills.

Anne Gray, an economist and the report's author, argues that employees in most need of educational and training opportunities are often denied them because they are working long hours. To overcome this, she says, people should have a right to unpaid study leave and the UK government should provide tax relief on employee and *employer contributions* made into a "sabbatical fund" used to help fiance periods of study. In addition, she says, the government should encourage employers, training and enterprise councils and trade unions to pilot work-sharing arrangements linked to training or learning opportunities.

Such policies, she says, could help create jobs for people recruited to cover for those on study programmes and companies would benefit from employees with greater skills. The report costs £15 ($24).

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IT Appointments

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Money can't buy artistic integrity

Cash may have been lavished on Verdi's 'La forza del destino' but the company seems culturally bankrupt, laments Andrew Clark

Is La Scala bankrupt? Judging by the "sold out" signs at the great Milanese opera house, the answer must be no. Elsewhere in Italy, opera may be chronically underfunded, but there has never been a shortage of money at La Scala: it's a national heritage site which attracts preferential treatment. And there's no skimping or scraping in the new production of *La forza del destino*. All 11 scenes of Verdi's sprawling epic are treated to a different design, and sets as lavish as these don't come cheap. The scenic opulence of *Forza* suggests a budget of mammoth proportions, worlds away from the single-set stagings that have become the norm in the UK.

Forget the force of destiny; what counts in Milan is the force of the maestro

But if it's the *artistic* balance-sheet we're talking about, then bankruptcy is not too strong a word. La Scala's orchestra and chorus still know how to perform Verdi better than anyone else – *Forza* is reassuringly clear on that – but they seem to be performing in an artistic vacuum. This is the only Verdi to be staged at Milan this season, and it is woefully undercast – which makes you wonder why La Scala chose to stage it. Even worse, Hugo De Ana's sub-Zeffirellian production has nothing to say about the piece or its characters. It's some achievement to make *Forza* look boring – but that's exactly what La Scala has done.

Perhaps Riccardo Muti, La Scala's *de facto* artistic director, had his fingers burned last season by Graham Vick's *Macbeth*, a disastrous attempt to create a new visual aesthetic for Verdi at La Scala. As the self-appointed guardian of Italian operatic tradition, Muti must have winced at that. *Forza* is his revenge. It represents a return to the staid, static traditionalism which gives opera a bad name. Forget the force of destiny; what counts in Milan is the force of the maestro.

And Muti leaves us in no doubt about his command of this performance. The overture is superbly drilled and contoured, as are the choral ensembles – above all the "Rataplan" at the end of Act 3, its clipped rhythms despatched with Donizettian precision. The flaw in Muti's approach is his inflexibility: his metronomic tempos give the performance a regimented quality, so that Verdi's melodies have no room to breathe. At least Muti has given up flailing his arms so wildly – perhaps out of deference to the spectacles he now wears while conducting.

With the centenary of Verdi's death less than two years away, La Scala is trying to refurbish its repertoire – and *Forza* represented a gaping hole. It had not been staged in Milan since 1978, and its local performance history, outlined in a lavish programme book, is one of unbroken distinction, with names like Toscanini, Gigli, Tebaldi, Bergonzi and Caballé leaping off the page.

In the 1980s and early 1990s, La Scala's Verdian priorities lay elsewhere. But having returned to *Forza*, it finds itself unable to match the opera's demands. This production underscores the worldwide crisis in casting Verdi: there are simply not enough good voices to go round. At best you might fill two or three concurrent productions – but this *Forza* was not one of them.

For Milanese opera-goers the main attraction was José Cura's Alvaro. The Argentine heart-throb certainly knows how to squeeze the money-notes, but those who see him as the next Placido Domingo would find scant evidence for it here. He phrased cautiously and looked strangely de-energised. Leonora was sung by Inès Salazar, a young South American soprano with a chest register notably more commanding than her top: "Pace, pace" was correctly sung, but far from elemental. Giacomo Prestia's Padre Guardiano might have been reciting the alphabet for all the stand-and-deliver expression he gave the part, while Leo Nucci's Carlo has seen better days. Luciana d'Intino's Preziosilla was hearty rather than tarty – and only Roberto De Candia, as the friar Melitone, showed any belief in his role.

But you can't blame singers for looking uninvolved when the director treats them as incidental to his stage-design. In a programme essay almost as indulgent as his production, De Ana explained how he had been inspired by the morbid visions of Valdés Leal, the 17th-century Spanish painter.

The result was a succession of dark, monumental friezes, beneath which any form of movement looked like an unwelcome disruption. This scenic pictorialism worked well enough in the big choral set-pieces, but it deadened the battle and inn scenes, and gave the intimate exchanges a stilted quality.

Where was the comedy and the tragedy? What about the issues that attracted Verdi to Rivas's Spanish Romantic drama in the first place – freedom, choice, social attitudes, racism, war? Verdi described *Forza* as a "modern opera". In its latest incarnation at La Scala, it looks like a relic from the Dark Ages.

Far from elemental: the South American soprano Inès Salazar as Leonora — Andrea Tamoni/Teatro alla Scala

CONCERTS IN BRITAIN

Maazel shows off his talents

Wednesday's concert at the Barbican was a notable event in the London music calendar: it gave us the chance to hear the world's highest-paid conductor in harness with a great British orchestra. Lorin Maazel used to be a regular visitor to these shores, but over the past decade he has focused his attention elsewhere, to notable effect in Munich. It's unlikely the London Symphony Orchestra was able to pay him what the Bavarians do, but it compensated by giving him *carte blanche* with the programme.

As Maazel approaches old age – he will be 70 next year – he is eager to let us know he can still do everything as well as anyone else, if not better. In that respect he's still a child, albeit a prodigiously gifted one. And so his programme consisted of Maazel, Maazel and Maazel – composer, conductor and violinist. Maazel's self-regard, like his natural musical ability, is breathtaking.

The only real surprise was that he remains a classy fiddler – though it was not especially evident from Bartók's *Portrait No 1*, which suffered from studied phrasing and uncertainty of pitch and rhythm. By the interval, however, Maazel and his violin were in full flow: Kreisler's *Gypsy Caprice*, using Maazel's own orchestration of the piano accompaniment, was fluently articulated, tender in tone, lavish in portamento and far from cold.

In between those two pieces came the UK premiere of Maazel's *Music for Violin and Orchestra*. It's a quaint programmatic rhapsody in an idiom – like that of so many conductor-composers before him – about 50 years out of date. Maazel dutifully absorbs the tricks perfected by early 20th-century master orchestrators, yielding a mildly discordant pot-pourri of Walton, Ravel, Stravinsky and Shostakovich. Tuned bongos, flexatone and gypsy dulcimer are thrown in for good measure, but the piece outstays its welcome. *Much Ado About Nothing* would be the correct subtitle.

After all that in the first half, it's a wonder Maazel didn't insist on programming *Ein Heldenleben (A Hero's Life)* after the interval. What everyone had come for, of course, was Tchaikovsky's Sixth Symphony, and Maazel the conductor did not disappoint. The first movement's development was fast and furious, the waltz icily elegant, the march a light-footed quick-step, the finale a perfectly tapered decrescendo. The LSO was simply immaculate, no more so than in Andrew Marriner's *pppppp* clarinet solos, the first time I have heard them truly as marked.

No one makes conducting look easier or more controlled than Maazel – but there lies his problem. His sheer facility with music, and the supreme self-confidence that comes with it, means he has never needed to reach beyond himself – the prerequisite for a great performance. Maazel's Tchaikovsky compelled admiration, but it never, never cut to the heart. In the context of the *Pathétique*, that amounts to failure.

A.C.

Maxwell Davies reels in new audiences

Because Sir Peter Maxwell Davies grows ever more prolific with the advancing years (he turns 65 soon, and has already completed four new pieces since the New Year), he gets far less notice in Britain than his music deserves.

When it ceased to sound "shocking" here, by the late 1970s, it still seemed forbiddingly knotty; and there were newer and slicker trends to write about. Also much wilder, knottier ones: Brian Ferneyhough's intricately wrought music, for example, and James Dillon's, are tougher and more opaque to innocent ears than almost anything Davies has composed.

Of late, it is America that has been discovering "Max". Just as his music turned toward transparency, oriented to "tonal" or at least "modal" roots, critics here began to think him less exciting than the latest breeds, whilst in America they were discovering him as a challenging original who makes an audible kind of *sense*. His recent San Francisco Symphony commission, *A Reel of Seven Fishermen* – a substantial work, a good half-hour long – had its UK premiere on Saturday in Manchester, with the composer conducting the BBC Philharmonic.

The BBC programme-book should have declared where the work came from, but meanly it didn't; so I must report that a reliable colleague, having heard a San Francisco tape, thought that it rendered some key events and passages more forcefully than the BBC orchestra. I don't doubt it, considering the executive brilliance – and the rehearsal-time – that the SFS can boast. In purely musical terms, nevertheless, the BBC Phil. did Davies excellent justice; they were fine-tuned and sonorous, and subtle with it.

The score is a seascape with human figures, inspired both by a George Mackay Brown poem that captures a timeless moment of Orcadian life (a mother on Hoy recognises that where 14 hands went to sea, only 12 have come home), and by a real, contemporary rogue-wave that nearly drowned Max himself on that island.

The music is built upon a Good Friday plainsong. The central Reel, a "dance of death", represents storm and crisis; it is flanked by a brooding salt-sea Prologue and a chastened, reflective Epilogue. The orchestral sound is often extraordinary, though it doesn't trade upon any of the standard film-music effects (perhaps the glockenspiel was inspired by Debussy's *La Mer*, though). Particularly memorable are the slow, deep trombones and tuba, which suggest a relentless ground-swell.

I look forward to a London performance soon. The rest of this concert was conducted by Vassily Sinaisky: a thoughtful account of Beethoven's Fourth Piano Concerto, with Kathryn Stott as bright-fingered soloist, and a searching, stirring one of Shostakovich's Sixth Symphony – beautifully played, with crackling quick movements.

David Murray

Out of Hades and into the sickbed

OPERA

RICHARD FAIRMAN

Orpheus and Eurydice
ENO, Coliseum, London WC2

The 'flu was the prime culprit. Two of the principal singers were forced to pull out of English National Opera's revival of *Orpheus and Eurydice* on Wednesday – bad luck in an opera which only has three roles.

This was only the second run of performances for this production at ENO, although those who saw it the first time round mostly thought it was doomed to failure whatever the cast. Gluck's best-known opera, for all its apparent classical simplicity, is far from an easy work to bring off and today's producers do not seem to be tuned in to its wavelength.

Almost all the good news about this revival was to be found in the orchestra pit. Having proven himself as an invigorating conductor in the baroque and classical repertoire, Roy Goodman duly energised Gluck's score with a racing pulse, punchy attack on the first beats of the bar, and bold "period"-style brass and drums. One surmises that he is less fond of slow tempos, as in his performances there generally are not any.

The drawback was that the music sometimes went too fast for the singers to utter their words with the appropriate sense of gravity. It is hard for Orpheus to lament in high tragic vein when the text is tripping over itself like a tongue-twister.

After music and poetry, dance also plays a part in operatic settings of the Orpheus legend, which is no doubt why two notable choreographers have recently been attracted to it – but, my goodness, one wishes they were not.

After Trisha Brown's cutesy handling of Monteverdi's *Orfeo* at the Barbican, the only good thing that can be said about Martha Clarke's contrasting treatment of Gluck's Orpheus opera is that it is very different.

It is hard for Orpheus to lament in tragic vein when the text is tripping over itself

Her dancers go into an ecstasy of avant-garde angst for the scene in Hades, twisting, jerking and twitching with a fervour that reminds us that 15 minutes of the wrong kind of modern dance really can be hell. But the bit everybody remembers from last time is the tableau in the Elysian Fields, where the dancers return to pose in a state of grace and not a stitch else.

I hope somebody warned ENO's replacement Orpheus about this part of the production, as it would be off-putting to sit in the dressing-room summoning one's concentration to sing "Che puro ciel", one of the summits of classical opera, only to step on stage and find the rest of the cast gambolling around without their undies. Andrew Watts sang that aria, like the rest of the role, cleanly and confidently, but with noticeably more power at the top of the voice than at the bottom.

As the replacement Eurydice, Julie Unwin supported him without obvious weakness and in the circumstances it was not their fault that the crucial final act between Orpheus and Eurydice failed to get a real grip on the drama. Mary Nelson sang a nicely bright Amor.

The chorus, placed in boxes on either side of the stage, came across strongly. Artur Stefanowicz and Margaret Richardson, the singers advertised for the title-roles, are expected to return before this run of performances is over.

Revival sponsored by Geoffrey C. Hughes Charitable Trust. Performances continue until March 31.

INTERNATIONAL

Arts Guide

BERLIN

OPERA
Deutsche Oper
Tel: 49-30-34384-01
Rise and Fall of the City of Mahagonny: by Kurt Weill, libretto by Brecht. New staging by Günter Krämer, conducted by Lawrence Foster, with designs by Gottfried Pilz and Isabel Ines Glathar; Feb 28

CARDIFF

OPERA
Welsh National Opera
Tel: 44-1222-464 666
Hansel and Gretel: by Humperdinck. Conducted by Wladimir Jurowski in a staging by Richard Jones, premiered in December. Cast includes Imelda Drumm, Linda Kitchen and Nigel Robson; Feb 26

EDINBURGH

OPERA
Scottish Opera, Edinburgh Festival Theatre
Tel: 44-131-529 6000
● Der Rosenkavalier: by R. Strauss. New staging by David McVicar, conducted by Richard Armstrong. The cast includes Joan Rodgers; Feb 27
● The Magic Fountain: by Delius. Conducted by Richard Armstrong in a new staging by Aidan Lang, with designs by Ashley Martin-Davis; Feb 26

HARTFORD

EXHIBITION
Wadsworth Atheneum
Pieter de Hooch (1629-1681): previously seen at Dulwich Picture Gallery, this first-ever one-man show of the Dutch painter offers a reassessment of his work. Less celebrated than his contemporary, Vermeer, de Hooch was a pioneer in his own right, and a specialist in maternal and domestic subjects; to Feb 27

LONDON

CONCERTS
Barbican Hall
Tel: 44-171-638 8891
London Symphony Orchestra: conducted by Lorin Maazel in works by Schubert and Bruckner; Feb 28
Royal Festival Hall
Tel: 44-171-960 4242
Philharmonia Orchestra: conducted by Christoph von Dohnányi in works by Haydn, Schoenberg and Beethoven; Feb 27
DANCE
Sadler's Wells
Tel: 44-171-863 8000
● Arc Dance Company: The Return of Don Juan, in a new staging by Kim Brandstrup, starring Irek Mukhamedov. With an original score by Kim Helweg; Mar 1, 2, 3
● Pacific Northwest Ballet: London debut for the company, which brings a mixed programme of American works (Feb 22-24), and Francia Russell's staging of Balanchine's *A Midsummer Night's Dream* (Feb 25-27)

OPERA
English National Opera, London Coliseum
Tel: 44-171-632 8300
Parsifal: by Wagner. Conducted by Mark Elder in a new staging by Nikolaus Lehnhoff, with sets by Raimund Bauer and costumes by Andrea Schmidt-Futterer. Cast includes Kim Begley and Jonathan Summers; Feb 26; Mar 3

MANCHESTER

CONCERT
Bridgewater Hall
Tel: 44-161-907 9000
BBC Philharmonic: conducted by Edward Downes in works by Elgar; Feb 27

MUNICH

CONCERTS
Philharmonie Gasteig
Tel: 49-89-5481 8181
● Beethoven Academie: conducted by Christopher Hogwood in works by Mozart and Haydn, with piano soloist Stefan Vladar; Mar 3
● Rundfunkorchester des Bayerischen Rundfunks: conducted by Marcello Viotti in works by Puccini; Feb 28
● Sinfonia Varsovia: conducted by Yehudi Menuhin in works by Mendelssohn-Bartholdy and J. Brahms; Mar 2

DANCE
Philharmonie Gasteig
Tel: 49-89-5481 8181
Bolshoi Ballet: mixed programme of Russian works; Mar 1

NEW YORK

CONCERTS
Avery Fisher Hall, Lincoln Center
Tel: 1-212-875 5030
www.lincolncenter.org
New York Philharmonic: conducted by Kurt Masur in works by Beethoven and Liszt. With piano soloist Hélène Grimaud, viola soloist Rebecca Young and the American Boychoir; Feb 26, 27

OPERA
Metropolitan Opera, Lincoln Center
Tel: 1-212-362 6000
www.metopera.org
Moses and Aron: by Schoenberg. Conducted by James Levine in a staging by Graham Vick, with sets and costumes by Paul Brown. Cast includes Philip Langridge and John Tomlinson; Feb 26

PARIS

OPERA
Opéra National de Paris, Opéra Bastille
Tel: 33-1-4473 1300
www.opera-de-paris.fr
Macbeth: by Verdi. Conducted by Gary Bertini in a staging by Phyllida Lloyd, with designs by Anthony Ward. Cast includes Jean-Philippe Lafont and Maria Guleghina; Mar 2
Opéra National de Paris, Palais Garnier
Tel: 33-1-44439696
www.opera-de-paris.fr
La Clemenza di Tito: by Mozart. Conducted by Ivor Bolton in a staging by Willy Decker with designs by John MacFarlane. Cast includes Theo van der Walt and Christine Goerke; Mar 1

POTSDAM

EXHIBITION
Cinema Museum
Leni Riefenstahl: first major German exhibition of the film maker since the war. Includes films produced during the Nazi period and more recent photographic work; to Feb 28

ROME

EXHIBITION
Palazzo delle Esposizioni
Tel: 39-06-474 5903
Poussin: Early Years in Rome. Display of 41 works produced between 1624 and 1628. The centrepiece is 'The sacking of the temple in Jerusalem by Titus' (1625/6), commissioned by the Barberini family and rediscovered by Denis Mahon, the show's curator. Includes major public and private loans from Europe and the US; to Mar 1

SAN FRANCISCO

CONCERTS
Davies Symphony Hall
Tel: 1-415-864 6000
www.sfsymphony.org
San Francisco Symphony Orchestra: conducted by Jeffrey Tate in works by R. Strauss, Humperdinck and Honegger. With flute soloist Paul Renzi and horn Julie Ann Giacobassi; Feb 26, 27

SEATTLE

OPERA
Seattle Opera
Tel: 1-206-389 7676
www.seattleopera.org
Vanessa: by Samuel Barber. Conducted by Yves Abel in a staging by Sharon Ott. The title role is sung by Sheri Greenawald/Ashley Putnam; Feb 27, 28; Mar 3

TOKYO

CONCERTS
Suntory Hall
Tel: 81-3-3564 9999
● Orchestre National du Capitole de Toulouse: conducted by Michel Plasson in works by Fauré, Saint-Saëns and Ravel, with violin soloist Daishin Kashimoto; Feb 26
● Tokyo Symphony: conducted by Hiroshi Wakasugi in works by Haydn and Mahler; Feb 27
● Yomiuri Nippon Symphony Orchestra: conducted by Rafael Frühbeck de Burgos in works by Falla and R. Strauss; Feb 26

VIENNA

EXHIBITION
Austrian Museum of Applied Arts
James Turrell: retrospective of the American artist who incorporates the elements into his architectural designs. Including two site-specific installations, the show also features photographs and drawings of the extinct volcano in which Turrell has been working since the 1970s; to Mar 21

TV AND RADIO

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● **CNN International**
Monday to Friday, GMT:

06.30: *Moneyline with Lou Dobbs*
13.30: *Business Asia*
19.30: *World Business Today*
22.00: *World Business Today Update*

● **Business/Market Reports:**
05:07; 06:07; 07:07; 08:20; 09:20; 10:20; 11:20; 11:32; 12:20; 13:20; 14:20.

At 08:20 Tanya Beckett of FTTV reports live from LIFFE as the London market opens.

COMMENT & ANALYSIS

PHILIP STEPHENS

Liberated by Europe

Tony Blair has put himself at the head of Britain's pro-European forces. Resolute action now needs to follow this bold gesture

Sometimes we learn a lot more from watching politicians than from listening to them. It happened this week when Tony Blair mapped out Britain's path to the euro. What we heard was a prime ministerial statement liberally sprinkled with the familiar caveats and caution. What we saw was a prime minister liberated from his past timidity.

Mr Blair's demeanour told us something he has always said but we have never quite believed. He is the first occupant of 10 Downing Street since Edward Heath serious in his intent to make a success of Britain's relationship with its continental neighbours. Joining the euro within a credible time-frame is the *sine qua non* of this ambition. But it is only part of it. After lingering too long in the shadow of a chauvinist press, Mr Blair suddenly looks comfortable in the role of the pro-European. Here is a stage he wants to play on. And if this venture fails, so does its author.

In staking his leadership on participation in the single currency Mr Blair seeks a prize bigger than the vital yes vote in the referendum all but promised for the months after the next general election. To secure the consent of the people to give up sterling Mr Blair must regrind the prism through which Britain looks across the Channel. The European Union is seen now as an institution to be fought or feared. Mr Blair has to persuade the voters that it is something Britain is part of, a co-operative if also an occasionally competitive venture.

The moment, it must be said, is not the most propitious. The hostility of British public opinion towards the single currency is well known. And these are distinctly awkward times to preach the gospel of Europe.

A few weeks ago Dominique Strauss-Kahn, France's finance minister, was heard on these pages declaring that Europe now laid claim to an equal voice with the US in the councils of international economic management. What we saw instead at last weekend's meeting of finance ministers from the Group of Seven industrial nations was a euro-zone fractured against itself. Europe's politicians could hardly be further from the central bankers they so recently anointed.

Wim Duisenberg, the head of the European Central Bank, looks ever more like someone whose mission is deflation. A small man's *amour propre* blinds him to the obvious truth that the Central Bank can succeed only if it builds political legitimacy. Mr Duisenberg, we must suppose, will eventually learn. And the present arrangements are not immutable. The question is the price to be paid by the euro-zone's depressed economy in the meantime.

There are other conflicts from which Mr Blair cannot escape. The haggling over money and the common agricultural policy, which *starts in earnest at today's* EU summit in Bonn, will be a dispiriting affair. All logic says that each of the 15 governments must give something now to secure the mutual gain of European enlargement. But after this week's declaration, Britain's Eurosceptic press has never been more eager to see Mr Blair fail. The necessary renegotiation of the rebate on Britain's contributions to Brussels has already been cast in the headlines as an abject surrender to the foreigners.

And it is here that we see the scale and the importance of the task Mr Blair has now assumed. It is worth recalling that for all but a year or two of the quarter of a century since Mr Heath signed the treaty of accession, the European Union has been seen from British shores as a zero sum game. Harold Wilson and James Callaghan were sullen if not hostile. Margaret Thatcher put her name to deeper integration but always pretended otherwise. Her scepticism turned to phobia. John Major's good intentions were broken on the rocks of Black Wednesday when sterling was forced from the exchange rate mechanism.

We should not be surprised then that the nation's voters harbour misgivings. They have been told again and again that this is a battlefield on which *Britain occasionally wins* but more often loses. Brussels, in tabloid parlance, is the place where malicious foreigners conspire against noble Anglo-Saxons. The slightest possibility that there might be advantage for Britain in marching in step has been inadmissible. Europe is something to be suffered, at very best endured.

Mr Blair has always believed the counter case. The difference after this week's statement is that he presents himself as its chief spokesman. No more hiding behind business, no more pretending that he might, after all, prefer the Queen's head on the currency to a place at the table in Europe. The sharing of sovereignty, as he said explicitly on Tuesday, is designed to enhance the nation's power and prosperity – just as the unsplendid isolation of his opponents would diminish it.

I cannot think of a serious politician beyond the shores of British Europhobia who would find anything remarkable in such an observation. But what is obvious to the French, the Germans or the Belgians has been a secret well-hidden from Mr Blair's electorate.

So the campaign for participation in the euro must be painted on a wider canvass. Mr Blair understands this. It explains his eagerness to shape a new social democracy which draws the best from European social policy and marries it with the entrepreneurial instincts of American capitalism. He needs his domestic audience to feel that the economic arguments are going Britain's way – as indeed they have been since long before his election victory.

Here too lies the explanation for Mr Blair's willingness to risk irritation and more in Washington by adopting the cause of European defence. His proposals for a European dimension to Nato, capable of military action independent of the US, have thus far passed almost unnoticed in his own country. But the project, now in the hands of a combined British, French and German taskforce, is of potentially momentous consequence.

The Paris government still cannot quite believe last December's St Malo declaration when Mr Blair put aside decades of traditional hostility to anything that put the slightest question mark over US military leadership. But nowhere else does he have a better chance to show that Britain is a beneficiary of, rather than a hostage to, European co-operation.

Mr Blair will find it hard to translate such initiatives into a change of mood at home. The habit of shouting and sulking is ingrained. The mindset of the sceptic media turns every legitimate argument between Britain and its partners into a test of the whole enterprise. And more than once Mr Blair has fallen into the trap of waving aloft the national veto for the sake of a favourable headline.

And yet the transformation he now seeks is far from impossible. The pro-European case has never been put with force and consistency by a prime minister as popular as this one. And every opinion poll which says that the British mistrust Europe also says they know they must be part of it. That is why an increasingly strident anti-Europeanism has failed to deliver votes to William Hague's Conservatives. Mr Blair can win. What's required now are words to match the body language.

LETTERS TO THE EDITOR

GM soya and maize not approved

From S. Leubuscher.

Sir, Allow me to point out an important error in Guy de Jonquières' analysis "Genetically modified trade wars" (February 18). The US Food and Drug Administration does, indeed, require extensive testing of products prior to approval. The FDA did not, however, approve GM soya and maize.

These food crops were exempted from the FDA's testing regime as the result of a policy decision by the Reagan administration. Rather, they have been approved under a vastly simplified Department of Agriculture regime, which merely asks that a crop be shown not to be a plant pathogen.

Mr de Jonquières might also find it interesting to read through Monsanto's "scientific" submission for soya approval, for which no toxicological or ecotoxicological testing was carried out. This product, which is causing the greatest concern in Europe, was submitted to what were termed "animal wholesomeness" tests, all of them minimal in nature and sloppy in conception.

Indeed, Monsanto dismissed the significant degree of liver necrosis seen in their rat tests on the grounds that necrosis was also found in the control group.

This is a serious issue, given the plans of the "life sciences" companies to ensure that all basic crops be modified within the next decade.

Articles that purport to take the underlying scientific and regulatory regimes into account therefore have a duty to go beyond repeating industry briefings.

S. Leubuscher,
60 Remsen Street,
Brooklyn,
New York 11201,
US

More ammunition for the eurosceptics

From Mr A. E. J. Killick.

Sir, The unfortunate juxtaposition of your editorial "Euro landmark" and the article "Germany's blame game" (February 24) does Tony Blair, the UK prime minister, no favours; nor, I suspect, the FT's policy on the euro.

Whether Germany's problems are structural, fiscal or monetary, being in the single currency has denied them the option of using interest rates to get the economy moving. While this problem was always seen as one of the fundamental drawbacks of the single currency, for it to come along so early in the life of the euro is particularly significant and must give ammunition to the eurosceptics.

Will the European Central Bank maintain its tough stance vis-à-vis the mightiest economy in Europe, or will it succumb to Oskar Lafontaine's bully-boy tactics? If the latter, does it mean that when we are in the single currency, our economy will be decided in Bonn/Berlin or Frankfurt? What will happen when Germany is the only country in step?

Mr Blair proposes using my money (as a taxpayer) to convince me that Britain must join the single currency. Will he also use my money to convince me that Britain should not join, so that when the referendum comes I can take a fully informed decision? If we are moving into an economic Wonderland, perhaps Mr Blair would find it easier to consult Alice.

A. E. J. Killick,
managing director,
Cyclop International,
P. O. Box 541,
Croydon,
Surrey CR9 8QN,
UK

Wintering in Winnipeg is healthy and fun

From Ms Anna Maria Magnifico.

Sir, The Canadian city of Winnipeg and its outstanding citizens are evidently not well known to the Observer (February 4). Far from being a place that one would wish to avoid visiting due to a perpetual winter freeze, Winnipeg and other northern cities around the world join in celebrating their winter season as healthy, productive and fun.

The Observer and readers of the Financial Times should also know that Winnipeg is the home of one of the world's foremost contemporary diplomats, Lloyd Axworthy, the Canadian foreign minister who has spearheaded such important initiatives as a new international criminal court and the ban on landmines.

So, next time you hear the place mentioned, think of the Man from Winnipeg, and applaud.

Anna Maria Magnifico,
former European trade and investment representative for Manitoba,
Akkerwindestraat 15 B,
3051 LA Rotterdam,
Netherlands

Number One Southwark Bridge, London SE1 9HL

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Developing a capitalist taste for litigation

Two court cases in Shanghai reveal the unexpected growing pains of the rule of law in China, says James Harding

Just as Qian Yuan was leaving Watson's, a pharmacy on one of Shanghai's busiest shopping streets, the store alarm went off.

The 19-year-old university student was taken down to the basement and searched for shoplifting. She was scanned with a portable electronic detector. Then, much to her embarrassment, she says, the female security guard asked her to unzip her trousers, twice. On both occasions, nothing was found.

The incident might have remained nothing more than a personal humiliation, but Ms Qian decided to take Watson's to court.

Last September, she sued the store, which is owned by the Hong Kong-based company Hutchison Whampoa in which the magnate Li Ka-shing has a substantial stake, demanding compensation for her mental anguish. She said she was "picking up the legal weapon to demand justice and safeguard her human dignity".

The district court found resoundingly in *Ms Qian's* favour – Watson's was ordered to place an apology in Shanghai's most popular daily newspaper and pay damages of Rmb 250,000 ($30,000), equivalent to roughly 20 years' pay for an average Shanghai worker.

Ms Qian is one of a growing breed of litigants in China. Where once disputes were handled by an official, adjudicated by a neighbourhood Party committee or, simply and frequently, left unresolved, these days more and more Chinese people are turning to the courts.

And, handsome pay-outs for personal injury, emotional distress and mental anguish are turning the business of accidents into something of a legal industry. When misfortune strikes, many Chinese people now call a lawyer.

Zhang Yuqi, a former Shanghai policeman-turned-attorney, says he was inundated with requests for representation after he secured a Rmb 130,000 compensation last year for a client who walked into a glass wall at a department store in which foreigners had invested.

"Ordinary people have tended to solve their problems between themselves. Average consumers do not know how they can protect their legal rights through the courts. But, things are changing. They are beginning to realise how the law can help them," he says.

The signs that Chinese people are starting to show a litigious streak may suggest that a Communist-run country is moving towards a rule-based society. But, the cases themselves illustrate how very far China has to go – they have exposed a patchy set of legal statutes and an often arbitrary court system.

> **'Ordinary people have tended to solve problems between themselves. Consumers do not know how to protect their legal rights through courts. But things are changing. They are beginning to realise how the law can help them'**

Foreign investors or, more recently, Hong Kong's judiciary, who often despair at Beijing's erratic or partisan enforcement of laws and regulations, are not the only ones left scratching their heads at the uneven hand of the law in China.

Initially, the two big cases in Shanghai – the one suit against Watson's and the other against the Metro-Jinjiang store handled by Mr Zhang – reinforced suspicions that China operated one set of rules for local companies and another for foreign ones.

Damages for mental anguish until recently were a symbolic Rmb 100-200, says one lawyer at a leading European law firm. But, he says: "A two-tier system seems to be developing. The courts appear to have reached the conclusion that foreign companies can offer rich pickings for local litigants."

The scale of the award for Ms Qian created something of a stir in Shanghai, simply because the size of the compensation payment seemed astronomical to ordinary people. But, the government seemed to consider the level of damages a mark of progress.

"Greater contact with other countries since the reforms and opening up began, has made the Chinese understand the importance of reparations," an official report explained.

More modest damages underestimated the extent of the victim's suffering and "did not teach others a lesson". Lawyers, too, have naturally been in favour of higher compensation payments, as they tend to be paid on a percentage of the final award.

Mr Zhang says overseas companies are not the particular targets of Chinese plaintiffs. He lists other recent cases in the city, such as the Rmb 120,000 damages paid by a local advertising company to the family of a man killed when one of their hoardings collapsed.

However, *the Watson's* case has more than just fostered speculation about the anti-foreign instincts of Chinese courts. For many, it has confirmed concerns about the independence – or lack of it – of legal judgment in China.

Last month, the case took a puzzling turn. Watson's appealed. The store has maintained that Ms Qian was never body-searched. The Shanghai No. 2 Intermediate People's Court still judged that Watson's had violated the human dignity of Ms Qian, but decided the award was too high. Instead of Rmb 250,000, the sum was reduced to Rmb 10,000.

This was "inexplicable" to Zheng Chuanben, the woman's lawyer. If the appeal court agreed that Watson's had violated Ms Qian's dignity, why did it lower the compensation payment by such a huge margin?

The speculation has been that pressure – either from other foreign retailers or domestic political interests eager not to displease Watson's chief owner, the powerful Li Ka-shing – were brought to bear on the Shanghai courts.

Indeed, a spokeswoman for Hutchison Whampoa, which owns the shop, acknowledges that there was "a lot of pressure from retail people. It was not just a Watson's issue. It became a supermarket operator issue". But, she says, Hutchison left *the Shanghai division of* Watson's to handle the case. Certainly, she says, Mr Li was not involved.

Whatever the background to the revised verdict, it has left many people perplexed. Like many other areas of the law in China, the rules governing personal injury and emotional distress awards are a collage of statutes, regulations and directives that sometimes overlap, sometimes contradict and often leave large areas blank. "There is not a very clear basis in China's Civil Law for emotional compensation for personal injuries," says Mr Zhang.

Indeed, the experiences of *the eager new band of Chinese* litigants suggests that recourse to the rule of law in China by no means guarantees a transparent, level and fair hearing.

As a confused Mr Zheng, the lawyer for the body-searched Watson's shopper, asked simply after the compensation payment for his client was slashed: "Where are the legal reasons?"

PERSONAL VIEW JACQUES SANTER

Thumbs up to reform

The European Commission has made substantial mistakes in handling its finances. To regain credibility, it must implement radical change and open itself up to public scrutiny

Santer (top, centre) has called for an accountable Commission

Over the past few weeks we have witnessed a crisis of public confidence in the handling of the European Union's finances and in the European Commission itself. It is not the first such crisis, but it is by far the most serious in terms of its impact on public opinion.

I am determined to make this episode a catalyst for change that will enable us to transform the Commission, and indeed the EU as a whole, into the most efficient, transparent and responsive administration in Europe. That is why I have asked the 15 government leaders to discuss EU reform with me as a matter of urgency at their informal summit in Germany today.

The first step must be for the Commission to accept that mistakes have been made and to ensure they are never made again. The Commission is the main symbol of European integration in the eyes of most people. It must get its own house in order if it is to regain their confidence.

That confidence is indis*pensable if the Commission* is to make a success of the tasks it faces this year. These include reshaping the EU's entire finances for the next seven years, overhauling Europe's agriculture and regional funding policies, and building Europe-wide guidelines for improved control of immigration, extradition and cross-border crime.

The second step must be for the Commission to respond boldly and positively to the requests made by the European Parliament when the assembly narrowly avoided censuring the Commission last month. That vote was a salutary reminder that the Commission's future credibility rests on its ability to manage EU funds soundly. I unreservedly welcome the Parliament's action as a sign that democracy is coming of age at European level.

As a start, we have given a group of independent investigators carte blanche to examine all the Commission's staff and files, without exception. I challenge any government in Europe to show that they have opened themselves up to this degree of public scrutiny. We shall implement the changes needed to respond to the *investigators' recommendations* as soon as they report on March 15.

We must go further than merely investigating past mismanagement and fraud. Next month we shall establish new rules governing the conduct and responsibilities of all staff, from the 20 Commissioners down to officials at all levels. We will draw on best practice across Europe to achieve this.

We shall also propose a broader *remit for the anti-*fraudsters, either by creating a fully independent European anti-fraud office or by beefing up the powers and independence of the Commission's anti-fraud unit. We have already tripled the size of this unit to 140 staff since it assumed investigative powers five years ago. It is now time to go further.

In April we will launch new policy options on staffing, including streamlined disciplinary measures for Commission employees found guilty of irregularities or fraud. And we will tighten up the criteria for appointing national civil servants to top jobs in Brussels. Most recruiting is internal, but we still need outside staff in order to remain responsive to political sensitivities in *each country.* We will present clear rules to ensure these are limited to the very best candidates.

We will also clarify the rules on outsourcing specific tasks to independent experts. Far more alleged fraud is traced to organisations operating at arm's length from the Commission than to the latter's officials.

The third step must be to put fraud into its true perspective. To exaggerate the *threat could lead* to the ill-conceived creation of layers of control that make fraud detection more difficult. Out of 1,000 investigations conducted by the Commission's anti-fraud unit over the past five years, only 27 suspected cases of fraud or conflict of interest concerned Commission staff directly. When set against the projects and contracts handled through the EU budget each year, which number over 100,000, this is a drop in the ocean. But it is still 27 too many, and zero tolerance must remain our overriding goal.

Most important is the need *to improve co-ordination* between all those who handle EU funds, from Brussels down to the smallest local authority. With over four-fifths of the €85 billion annual European budget spent by the 15 governments (not the Commission), the fight against fraud will fail if all actors do not pull together simultaneously.

The fourth step must be to redefine the core tasks facing the Commission – ranging from foreign policy and trade to employment, industry, the environment and competition policy – and then to remould the Commission to meet those tasks. This means restructuring departments, overhauling financial management and building a more responsive and motivated workforce. I am determined to equip my successor next year with the blueprint for a modern, accountable Commission.

There is only so much the Commission can do on its own, however. For too long, it has had difficult tasks thrust upon it by the EU's member governments, without a second thought for the resources required to achieve the objectives. Too often the Commission feels it is being asked to drive a Mercedes with the engine of a Trabant. Any organisation required to spend money without enough trained staff to disburse it has to rely heavily on outside expertise. And where the spender is too overstretched to exert financial control over all outside operators, the fraudsters will never be far away.

This is not necessarily a plea for more resources; it may often mean that governments should ask less of the Commission. It is, above all, an urgent call for the European Union as a whole to match its tasks with the means to achieve them.

These are some of the lessons. Where they concern the Commission, I will ensure they are swiftly taken on board. Let us seize this opportunity to accelerate reform, rebuild trust and reshape the Commission for the future.

The author is president of the European Commission

COMMENT & ANALYSIS

FINANCIAL TIMES
Number One Southwark Bridge, London SE1 9HL
Tel: +44 171-873 3000 Telex: 922186 Fax: +44 171-407 5700
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Genetic seeds of discord

The failure this week of talks in Cartagena, Colombia, on regulating trade in genetically modified (GM) crops and foods might, at another time, have elicited only passing interest. But the recent outcry in Europe about these products and the bitter recriminations at the meeting give the outcome greater significance. It not only shows how widely countries differ on this contentious issue; it could make solutions still harder to find.

The talks envisaged a treaty requiring exporters of GM products to obtain prior approval from importing countries. Developing countries, with European Union support, say they need such safeguards against health and environmental risks, which they lack the capacity to assess or control. But several farm exporting nations, led by the US, resisted the proposal, saying it could unduly restrict trade and conflict with World Trade Organisation rules.

Mutual mistrust among the participants helped turn discord into deadlock. The US suspected the EU of conspiring to use the talks to foment international opposition to GM products and justify closing its own market to them. The US, in turn, was widely accused of invoking world trade rules as a pretext to sabotage a plan which threatened the business of its biotech industry and farm lobbies.

The acrimony and polarisation make still harder the task of reaching agreement when the talks resume in 18 months, and of bridging EU-US differences on GM products. Indeed, there is a risk that US obduracy in Cartagena will hand ammunition to those in Europe who claim its sole purpose is to promote the interests of American exporters.

The Cartagena debacle is the more regrettable, because at the core of the debate lie serious issues. International differences over GM foods are just one – admittedly glaring – example of growing tension between public concerns about health and environmental safety, on the one hand, and open markets and world trade rules on the other.

The problem arises, in part, from mutual misunderstanding and ignorance on both sides of the argument. Environmental and health policies increasingly affect, and are affected by, international trade and investment. Yet even in national governments, these policies are formulated with little reference to trade policy. The consequence is incoherence and conflict.

If the Cartagena talks have accomplished anything, it is to underline the need to narrow that divide. That will not be easy, nor will it be achieved quickly enough to resolve current disputes over GM products. But tackling it now is the best way to reduce the risks of such discord in the future.

Telecom Italia

The transformation of Italian capitalism has been predicted, with unfailing regularity, in each of the past 20 years. There are reasons to think, however, that the attempt by Olivetti to take over Telecom Italia really marks such a watershed. The government can help ensure this transition – if it chooses.

Italy's big companies are emerging from their distinctive shadowy capitalism, in which family groups and politicians exercised a murky and ill-defined influence. Surely an aggressive, highly-leveraged bid by an entrepreneurial mobile phone company for a 'stodgy' former state monopoly confirms Italy's emergence from the shadows?

Up to a point. The fact that Olivetti has been able to build a successful mobile telephone business, and thus dare to mount a bid for Telecom Italia, is indeed a triumph for liberalisation. The fact that the contest will be conducted under a sensible takeover code is another. The way both chief executives – Roberto Colaninno of Olivetti and Franco Bernabe of Telecom Italia – are using the rhetoric of shareholder value is a third.

But there are other signs that some things change slowly in Italy. One is the involvement, in preparing the Olivetti bid, of Mediobanca, the Milan merchant bank which is the symbol of old-style Italian capitalism. Another was the early endorsement of the Olivetti bid by Massimo D'Alema, the prime minister. The government now says it is neutral, but Mr D'Alema, at least, does not quite seem to accept that Telecom Italia is outside the state's sphere of interest.

The truth is that in this battle it is Olivetti's opponent, Mr Bernabe, who best symbolises the future of Italian capitalism. He has managed his former charge, the oil company Eni, with explicit attention to shareholder value. Since his arrival at Telecom Italia three months ago, he has shown every sign of running the same way. And he is promising that his principal anti-Olivetti manoeuvre, a merger with Telecom Italia's separately quoted mobile phones subsidiary, will be put to a shareholder vote.

Because the shares are widely spread, this battle will indeed – as Mr Colaninno says – be a referendum on the future of Italian capitalism. The government can best ensure an appropriate climate for this vote by backing its protestations of neutrality with deeds. It should declare its intention of voting its golden share with the majority, and find an appropriate way of sterilising – or selling in the market – its 3.4 per cent remaining stake in Telecom Italia. Such moves will help ensure that this time the transformation of Italian capitalism will be more than just a slogan.

Bleak times

After months of deliberation, the International Monetary Fund will in the next few weeks decide whether to grant emergency loans to Romania. Without support, Romania will soon default on its foreign debt. But past IMF loans to Bucharest have been wasted because governments have failed to carry out promised market-oriented reforms. So what should the IMF do?

It is an uncomfortable question, as anyone dealing with Russia and Ukraine will recognise. Nobody wants to condemn some of Europe's poorest people to even greater poverty. But macro-economic aid only works if governments pursue reforms. The IMF should therefore tie any new loan to tough conditions. If Bucharest rejects the terms, the Fund should walk away.

The IMF has hitherto rightly been sceptical about the right-of-centre government's commitment to reform. Fine words have rarely been matched by deeds. But Radu Vasile, the prime minister, is now belatedly pushing his unruly coalition into action. In the last three months, he has privatised the telecoms utility and two banks. He is talking to Renault of France about selling a controlling stake in Dacia, the country's only carmaker. He has pledged to close loss-making state-owned enterprises, including 140 coal mines. And he has proved brave enough to arrest Miron Cozma, the miners' leader responsible for recent violent trade union protests.

The IMF must keep up the pressure by tying loan disbursements to further privatisation and restructuring and the implementation of a tight 1999 budget.

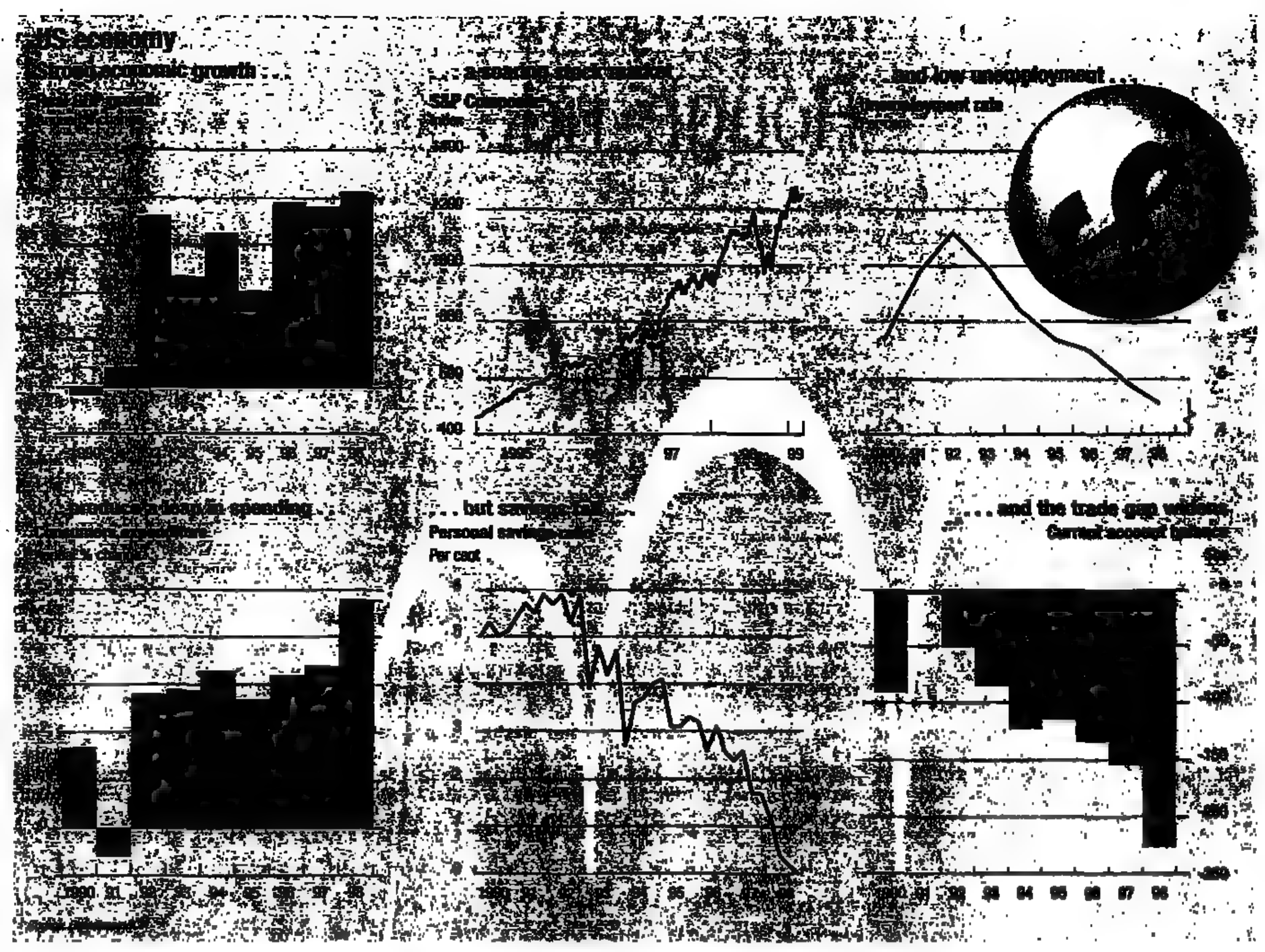
The lesson from the rest of ex-Communist Europe is that reform works, as in Poland and Hungary. But sustained pursuit of market-oriented policies is required: things go wrong if governments falter with restructuring, as in the Czech Republic.

None the less, western Europe should not neglect relations with those neighbouring countries which refuse the IMF's medicine. Otherwise, rejection might lead to isolation. Macro-economic aid is not the only way of helping eastern Europe. Educational exchanges are valuable. So are schemes which support market-oriented institutions, such as stock exchanges, and those which promote the growth of a civil society, for example, through training for bureaucrats, judges, and court officials.

Joint military exercises foster mutual confidence. Trade and investment build bridges, even with the worst-managed economies. The final aim should remain the eastward enlargement of western Europe's economic and political structures. The doors must be kept open for eventual entry into the EU and Nato – however distant this might seem.

Irrepressible exuberance

Alan Greenspan called it irrational but, says Gerard Baker, the exuberance of US spending is keeping the world economy afloat



If the world survives the the past year's financial turmoil without collapsing into a recessionary heap, it might consider offering its prayer of thanks to that most caricatured of modern economic phenomena, the American consumer.

To the casual observer, she (and it is very often a she) makes an unlikely heroine. Blocking out two car-parking spaces in her gleaming new 5-litre sport utility vehicle; clutching the $4 cup of steaming latte from the local coffee shop; shouting instructions to a broker on the mobile phone, or using up phone lines in airport lounges shopping electronically – this conspicuous consumption may not be socially and aesthetically pleasing.

But so far it has been the irrepressible exuberance of the US consumer that has kept the world economy going.

US spending on personal consumption rose by $334bn in 1998, an annual increase equivalent to the total yearly output of one of the medium-sized economies of east Asia. Between the fourth quarter of 1997 and the fourth quarter of 1998, consumption expanded by almost 7 per cent in real terms, the fastest year-on-year rate of growth in 15 years. Spending on durable goods – all those fast cars and faster computers – rose by 13 per cent.

If US consumption had been flat rather than buoyant, the economy would have eked out a mere 0.7 per cent growth rate last year, rather than the 4 per cent-plus growth it achieved. And the global impact would have been to reduce world growth by almost half the already meagre 2 per cent it managed.

With the world still waiting for sure signs of recovery in Japan and anxiously watching indications of a renewed downturn in Europe, the American consumer may still hold the key. But as the consequences at home and abroad of such unbalanced growth become starker in the form of ever tightening labour markets, a surge in household debt, and a yawning US trade deficit, the critical question for policymakers in the US and around the world is: can US spending continue at this level?

This week Alan Greenspan, the chairman of the Federal Reserve, repeated his now familiar warnings that the imbalances mean consumption growth must slow sooner or later. The economy was "stretched in a number of dimensions", he said, and gave a warning about the financial pressures which the strong spending growth had produced.

But are the conditions that have driven US consumption likely to produce the sharp deceleration Mr Greenspan and most economists seem to be expecting?

To the rest of the world, the one overwhelming factor behind the strength of the personal sector has been the stock market. As Wall Street's bubble has inflated, the argument goes, it has given consumers a false sense of financial security. When, as most outsiders seem to believe, the bubble bursts, the downside of casino capitalism will become obvious: consumption will collapse and the US success of the past few years will prove to have been as illusory as that of Japan in the late 1980s.

But this is an unduly simplistic view of the US economy. Yes, the wealth effect has played a role but it is far from the only one. Between 1995 and the end of 1998, Americans gained an estimated extra $6,000bn in the stock market. Conventional wisdom estimates that for every dollar of increased wealth individuals receive, they spend about 3 cents. That would suggest a consumption wealth effect of about $60bn per year, or a little under a third of the total increase in personal consumption.

But there are four other factors that have contributed to the surge in consumer demand over the past two years. They suggest the US spending surge is more broadly based than the "it's-all-based-on-a-stockmarket-bubble" explanation would suggest.

● The extraordinary growth in employment. The US labour market has absorbed 3m extra jobs a year since 1996, up from less than 2m per year in the first five years of the current expansion. The job growth has come from three sources: an increase in the population; an increase in the number of people joining the labour force, and a decline in the pool of unemployed workers. The last two have had a significant impact on consumption.

The so-called participation rate, the proportion of the total population that describes itself as available for work, has risen from 66.6 per cent in 1996 to 74 per cent today, the highest level ever. This means that individuals formerly not working at all – homemakers, welfare recipients, retired people – are now joining the labour force in large numbers, increasing their income significantly as a result, and adding to consumption.

The decline in the unemployment rate to a 28-year low of 4.3 per cent has not only increased consumption directly, but has provided an additional incentive to spend by dissipating the pervasive feeling of job insecurity that seemed to hold back spending growth in the early 1990s.

"The most important stock of wealth most people have is their labour," says Lawrence Lindsey, a former Federal Reserve governor. "When labour market conditions make people feel that stock of wealth is increasing long-term, they feel a lot better off."

● The first significant increase in wage growth in a decade. For most of the past 10 years, job insecurity led to moderation by workers in their wage demands, damping down spending. But Between 1993 and 1996, average annual wage growth was about 3 per cent. And in the past two years, the figure was 4 per cent. There are not only many more Americans working, but after years of stagnation their pay is at last rising.

> 'The most important stock of wealth most people have is their labour'

● Declining inflation. In 1998 especially this nominal wage growth was enhanced by a sharp fall in inflation to a rate well below what most people had anticipated. Falling oil prices, the strong dollar and continuing sharp declines in computer prices gave consumers big windfalls last year. As a result, real wages, bolstered by big productivity gains, increased at their fastest rate in 26 years.

● Falling interest rates. Lower inflation, and the international financial turmoil last year led to plummeting market interest rates. Average mortgage rates declined by more than one full percentage point in the 18 months to last December. Furthermore, the Federal Reserve has helped to maintain these low rates. Instead of acting to curb rapid demand growth by pushing interest rates sharply higher, as it might have in the past, the Fed has taken a more accommodating approach.

How many of these factors will continue to support consumption in the next year or so?

Economists, including Mr Greenspan himself have been forecasting for years that labour force and employment growth is certain to slow. The current participation rate is thought to be close to its ceiling, and the unemployment rate is probably near its floor. Yet expectations of a dramatic slowdown in employment growth have proved wrong in the past, and the more likely outcome is still for slower – but reasonably robust – growth.

In any case, a slowdown in employment growth might be compensated for by wage acceleration. If the unemployment rate does not rise significantly from its current low point – which seems probable – workers may become emboldened to push for higher compensation. In any case, changes in employment conditions often take a long time to become apparent in spending patterns – witness how US workers remained uneasy in the mid-1990s, long after the end of the brief recession of 1990-91.

Inflation is expected to flatten out this year, and perhaps even edge up slightly, perhaps limiting some of those gains in real terms. But while interest rates have risen in the past few months as fears of economic collapse have eased, the time lags usually associated with interest rate movements may not produce a significant impact on spending – at least for this year.

The stock market may restrain growth a little, even if it does not crash. The most bullish Wall Street analysts are not expecting the 20 per cent plus annual gains recorded in the past few years.

If you add in other factors that could restrain growth this year – investment could weaken if profits falter, and the external sector could deteriorate further if Latin America or Europe were to slow significantly – then it becomes clear that the overall conditions in 1999 are less favourable for consumption than they were in 1998. But, equally, there seems no reason to fear an impending collapse.

That leaves one last worry which might restrain consumption, independent of all these factors: the condition of US personal balance sheets. While income growth has been strong in the past two years, consumption growth has been even stronger. The personal savings rate has fallen steadily to its lowest level since the 1930s – and is now negative to an unprecedented extent. This weakness is reflected in broader imbalances – a large private sector financial deficit, and a growing indebtedness of the US private sector to the rest of the world. All that has prompted concerns that the American consumers will be forced to retrench in order to restore their long-term financial balances to more orderly levels.

But all this takes no account of the partially offsetting effects of the enormous increase in household wealth in the past few years. Stock market assets, pensions and houses have all increased in value substantially, and consumers' net balance sheet positions are less immediately worrisome.

Eventually, no doubt, Americans will be forced to unwind their financial imbalances. But for the foreseeable future, they seem on course to continue their spending binge, if not at the same frenetic pace of the last year, then at least by enough to keep the US, and, perhaps, much of the world afloat.

OBSERVER

Tearing up the rule book

If the goalposts at Copenhagen soccer club FCK are as flexible as the management's views on corporate governance, players might just as well hang up their boots and give arch rivals Brondby a clear shot at this year's Danish championship.

While Brian Laudrup and his team-mates are models of fair play on the pitch, FCK appears to play under its own set of rules with regard to the Copenhagen Stock Exchange.

Though the soccer club is under just the same obligation as any other publicly listed company to inform the stock exchange of any significant developments, the Danish media has an uncanny ability to get the story first.

Last Friday, a local TV station informed its viewers that FCK had signed a DKr50m sponsorship deal with brewer Carlsberg, but the club didn't get around to informing the stock exchange until Monday, by which stage the FCK share price had rocketed.

In November, the tabloids could tell the world that a homesick Laudrup was transferring from Chelsea long before the suits at the stock exchange were officially informed. The exchange is investigating the leaks, but patience is wearing thin, and the word on the street is that FCK could be struck off unless it starts playing by the same rules as everybody else.

To the rescue

Gen Surayuth Chulanont, Thailand's new straight-talking army chief, also becomes, by tradition, the chairman of the Thai Military Bank, in which the armed forces have a stake.

To the former head of the country's special forces, becoming a banker is a bewildering task, particularly with the bank scrambling to find new capital by the end of June to avoid being taken over by the government. And yet the general seems like a quick learner.

He promises reinforcements are arriving soon for the bank in the form of a "strategic partner" but says he can't elaborate. "One thing I have learned about the banking business is that there are so many secrets – maybe more than in the military."

Jerzy's move

The Polish government's failure to replace feisty EU affairs expert Maria Karasinska Fendler, who resigned just before Christmas as the head of Poland's key European Union integration unit, may have gone unremarked inside the country.

Not so in other European capitals. Poland's chief negotiator Jan Kulakowski is just back from a trip to Bonn, Rome and Lisbon where he's been preparing the ground for Poland's EU membership negotiations. He says he's been asked everywhere when the unit will get a new head – and he's had to tell everyone he doesn't know. Brussels, in particular, seems increasingly exasperated about the failure to make an appointment – given that the unit is seen as crucial if the reforms needed for EU membership are to become a reality.

Kulakowski, who spent six years in Brussels as Poland's ambassador to the EU, says he thinks prime minister Jerzy Buzek is aware of the problem. Whether he intends to do something about it is another matter.

Bank on it

The International Monetary Fund appears still to have some work ahead of it if it's going to build better bridges with crisis-scarred Asian countries. At a conference organised yesterday by the Asia Society in Manila, the biggest applause of the day came after some advice given by Gabriel Singson, Philippine central bank governor, to a panel of fellow central bankers.

"The Philippines has had 24 programmes with the IMF covering 35 years. The first lesson I learned is you don't have to follow everything the IMF wants you do to," says Singson, who's set to retire in July after 43 years in central banking.

"Secondly, even if you agree and you don't comply, you can always ask for a waiver."

After Pangalos

You'd think Greece's top politicians would have lobbied to become foreign minister after the sacking of Theodoros Pangalos for the bungling of the Ocalan affair.

Far from it. Two senior Socialists turned the job down almost as soon as it was offered. The first was defence minister Akis Tsochatzopoulos, who makes no secret of his ambition to succeed Costas Simitis as prime minister. Next was Costas Laliotis, public works minister and another possible contender for the Socialist leadership.

Neither is much of a linguist and both prefer wheeling and dealing in Athens to diplomatic schmoozing around Europe. What's more, they're both working on government contracts due to be awarded soon. Why risk losing political clout at home because you're spending too long on a plane?

So step forward George Papandreou, the US-born son of the late Socialist prime minister Andreas, who's taking the job. With a sociology degree from the London School of Economics, he's a good communicator. And for the moment at least, he doesn't seem keen to follow the family tradition of being prime minister.

The Financial Times 50 years ago

Competition From Germany and Japan
Manchester, Feb. 25.
Competition to be expected from Germany and Japan was described here to-day by Colonel F.J. Erroll, Conservative MP for Altrincham, as "an ominous new development" and, he said, foreshadowed considerable losses in hard currency earnings. He stated that the [UK Labour] Government had apparently decided that the German and Japanese economies were to be allowed to become self-supporting. But he doubted whether the implications of this policy were even yet being faced by the Government. He was addressing the Manchester branch of the National Union of Manufacturers.

Goodyear Factory
Wolverhampton, Feb. 25.
Pliofilm, a transparent package material, will be manufactured for the first time in Britain at a factory of the Goodyear Tyre and Rubber Company which was opened yesterday. The material, which can be used for wrapping anything from aeroplane engines to sandwiches, has been in use for some time in the United States, where it was first made by Goodyear Tire in 1939.

FINANCIAL TIMES

FRIDAY FEBRUARY 26 1999

THE LEX COLUMN

Rough ride

Had DaimlerChrysler's maiden results not come just after Volkswagen's gloomy prognosis, the market would hardly have knocked the shares down 4 per cent. Admittedly, Daimler merely met forecasts, while General Motors and Ford recently beat theirs. But the group still pushed up operating profits by a healthy 35 per cent to €8.6bn.

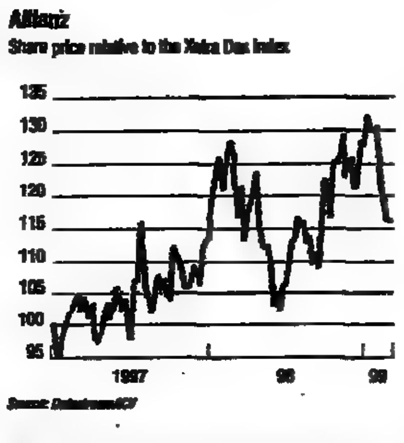
The real test comes this year, with investors expecting the first fruits of the merger. So far, the management is confident of delivering promised cost savings of $1.4bn for 1999, rising to $3bn in three years. Momentum within the company is strong, with a new, highly-profitable Mercedes S Class luxury car and a new Jeep Cherokee in the US. Daimler's truck, aerospace and services divisions are also doing well. Industry conditions are less positive. Even though VW's pessimism is probably overstated, European and US car sales are forecast to fall slightly, with Asia and Latin America remaining weak.

As the background deteriorates, however, investors should value the relative certainty of growth based on internal savings more highly. Group profits are expected to rise over 20 per cent this year and over 10 per cent in 2000, more than twice the level of the peer group. Some of this is in the price: Daimler trades at a one-third premium to the European car sector. But with potential for the savings to be greater than expected, the shares still look attractive.

Allianz

Allianz is right to play hardball with the German government over tax, but not entirely for the right reasons. In principle the proposed reform of corporate taxes, which replaces a raft of reliefs with a lower general rate, makes sense. But if the net effect is to push up tax bills, companies will try to dodge the impact. Allianz estimates that its extra tax payments will be DM2.5bn over four years. This would add a quarter to last year's bill of about DM2.5bn, substantially outweighing any benefit from the planned reduction in the general corporate tax rate from 45 to 40 per cent.

So, let the negotiations begin. The government does have a point in spotting that German insurers have over-generous reserves for future claims and losses. But the rules are being tightened to such an extent that the German regime would become one of the harshest in Europe. Solutions should include less punitive rule changes and speeding up further reductions in corporate tax to 35 per cent. Another bargaining counter ought to be the taxation of gains on selling non-core holdings. Much of Allianz's excess capital is tied up in this way. A cut in the tax rate on disposals would encourage it and many other German companies to stop acting as quasi-investment trusts. The cash could be used for share buy-backs – the easiest way for Allianz to improve its single digit return on bloated equity – and acquisitions.



Chile

Could Chile become the next victim of currency speculation? The peso has slipped 7 per cent to touch 500 to the dollar so far in 1999, and the country's usually relaxed central bank has intervened twice this week in the money markets in support.

Chile certainly has some typical Latin American weaknesses – a rapidly slowing economy, a current account deficit of more than 7 per cent of gross domestic product, and a currency linked to the dollar by a "crawling peg". With an election looming in December, the central bank is under political pressure to cut interest rates again, even though that would further weaken the peso.

But Chile also has strengths its neighbours lack, notably a record of free market policies, a well-run government and good public infrastructure. Most importantly – and in sharp contrast to Brazil – there is no debt problem. Total foreign borrowings of $30bn are mostly held by the private sector and only a fraction is short-term. Against that, the central bank has $15bn in reserves. And the relative cheapness of Chilean assets is attracting capital inflows – Duke Energy of the US has just bid $2.1bn for a stake in one Chilean electricity group, while Spain's Endesa has tried but failed to raise its stake in another. While it never does to underestimate the markets' enthusiasm to take aim at currency pegs – even moving ones – Chile should prove a poor target for the speculators.

British Aerospace

Does the completion of the new aircraft delivery phase of the Al Yamamah contract leave a gaping hole in British Aerospace? An embarrassingly large cash outflow – £839m at the operating level – due to ever-lumpier payments from the cash-strapped Saudi government highlights BAe's dependence on the deal. But this is slightly misleading. Since the year-end, the Saudis have paid BAe a large lump of cash. BAe is also sitting on a record £26bn order book. Orders are up 27 per cent and represent over three years' sales. So only the churlish could quibble with the visibility of BAe's revenue stream. Nor does Al Yamamah disappear altogether: related service arrangements account for 11 per cent of the order book.

The real issue is how effectively BAe can translate these orders into profits. Integrating Marconi into its existing low-profit systems business should lift margins to the 10 per cent level achieved by the defence division as a whole. And BAe will be better positioned to compete for top tier prime contracting roles. But the news from Airbus is bleak. Although BAe may have made a profit on selling Airbus components, Airbus itself suffered an operating loss of about £125m last year thanks to its price war with Boeing. The long-promised modernisation of Airbus's structure would help improve its profitability. But BAe shareholders should not hold their breath.

SKI RESORTS PREPARE TO REOPEN AFTER TRAGEDIES ON THE SLOPES

Tourists flock to the Alps despite fatal avalanches

By Elizabeth Robinson

Ski resort workers in the Alps yesterday fought to reopen roads and facilities closed by avalanches in time for the arrival of tens of thousands of tourists this weekend.

Severe avalanches have hit the region this year, claiming more than 50 lives.

Leukerbad, in Switzerland's Valais canton, was the latest town to be hit when an attempt made to trigger a controlled avalanche went wrong. Swiss radio reported that 30 people were rescued with no injuries.

With snow conditions expected to ease this weekend, most resorts were hoping to offer some skiing, despite the string of fatal accidents.

St Anton in Austria, which has had no ski-lifts this week, is expected to open today. Other resorts were operating only a fraction of their lifts. Lift operators typically only reimburse lift-pass holders if fewer than 5 per cent of lifts in the resort are working.

UK and continental European tour operators appeared divided on whether the avalanches were deterring skiers. TUI, the German travel company, said one third of its 1,000 bookings for ski holidays starting this weekend were cancelled by clients despite the operator offering to change destinations for free.

In contrast, French bookings remained strong for the coming week, the last of the school holidays. French operators said only 1-3 per cent of reservations for the next fortnight had been cancelled. UK tourism firms said business was normal. Inghams, the biggest independent ski operator, expects to carry 6,000 skiers to the Alps this weekend. It has had to transfer 15 people who were due to go this weekend to Galtür, the Austrian town that has been sealed off since two fatal avalanches on Tuesday. It reported no other changes in travel plans. Yesterday the Galtür death toll rose to 27, with 11 people still missing.

Laurence Hicks, sales manager at Inghams, said: "We're optimistic that the weather is improving and we're telling people to stay calm and turn up as usual." Andrew Dunn, managing director of Ski Scott Dunn, reported an increase in last-minute bookings. "Resorts are opening up and getting better. Potentially they can have a very good week."

Mr Dunn attributes the lack of UK cancellations to living up to "the Dunkirk spirit", but in reality this is more likely to be explained by UK tour operators' differing structure. UK skiers tend to pay in advance for inclusive packages, unlike their European counterparts, the majority of whom travel to ski areas independently and have nothing to lose from cancellation.

Travel around the Alps remains difficult. Swiss authorities said the Gotthard tunnel, which has been shut since last week because of avalanche danger, reopened for limited traffic. The San Bernardino tunnel was also closed after a truck accident, Swiss radio reported.

The Austrian Tourist Office in London said the road to Galtür would open tonight. Everyone was airlifted from the town yesterday. It said there was still a danger of avalanches in some areas. Winter tourism accounts for two thirds of Austria's total tourism receipts. Last season generated Sch158bn in foreign currency.

The long-term impact of the fatal avalanches on Europe's ski industry could be severe.

Andrew Moody, director of research for travel and tourism at PricewaterhouseCoopers in Philadelphia, estimates tour operators stand to lose tens of millions of dollars from cancellations, lawsuits and the implementation of contingency plans.

Mr Moody said: "We're getting reports from US resorts of increased requests over this past week.

"Europe is going to suffer a secondary impact from the risk involved. This type of thing sticks in people's minds."

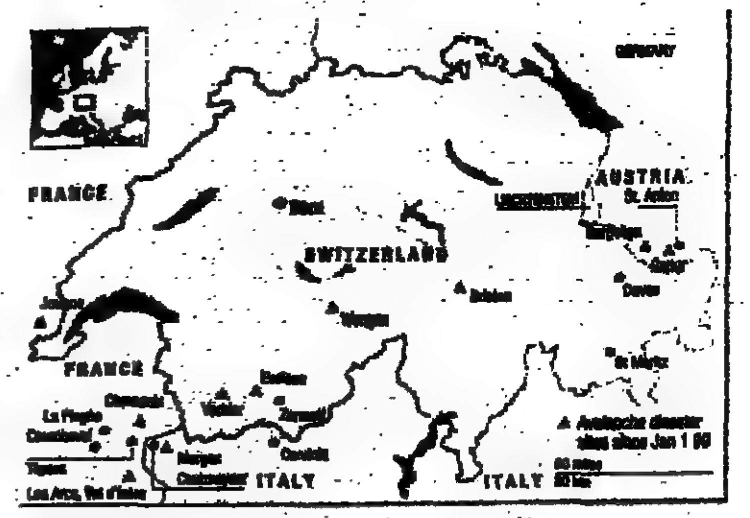
He said that although avalanches also occurred in the US, especially in the west, they were less severe than in Europe.

"It's a combination of height, steepness, the way the snow blows over the top, and where the towns are built," he said.

"They do not cause the death toll and havoc that they have done in Europe."

The Ski Club of Great Britain is advising independent travellers driving to the Alps to be prepared to stay at lower resorts which offer a greater percentage of working lifts and better weather conditions.

Vanessa Haines, spokeswoman for the club, stressed conditions were still dangerous for skiers. "Pisteurs have so much experience. If they say don't go off piste, you have to listen to that."



Ski slopes open at top resorts

France	%	Italy	%	Switzerland	%	Austria	%
Chamonix	20	Cervinia	40	Davos	6	Kitzbühel	90
Val d'Isère	67	Courmayeur	30	Zermatt	33	St. Anton	0
Courchevel	5			St. Moritz	100		
Tignes	50						
La Plagne	60						

CONTENTS

Workers in New Delhi were among about a million Indian bank staff on strike yesterday in a dispute over wages. Picture: Reuters

FT WEATHER GUIDE

Europe today

There will be heavy snow over central parts of Sweden and Norway. The south will be drier and milder with rain and sleet in places. Eastern Europe will have patchy, light snow flurries. Central Europe will be mainly dry, with sunny spells after any early mist or fog has cleared. France and the Iberian peninsula will be mainly dry and sunny. The eastern Mediterranean will have showers, but it will be dry and sunny in the rest of the Mediterranean.

Five-day forecast

North-west Europe will be unsettled with Atlantic fronts bringing spells of rain early next week. Rain will spread into Scandinavia, where it will turn to snow, and central Europe with fresh falls over the Alps. The eastern Mediterranean will be dry with spells of sunshine. The Iberian peninsula will have showers.

Situation at midday. Temperatures maximum for day. Forecasts by PA WEATHERCENTRE

TODAY'S TEMPERATURES

		Maximum Celsius
Abu Dhabi	Sun	27
Accra	Fair	33
Algiers	Sun	21
Amsterdam	Rain	6
Athens	Shower	15
Atlanta	Fair	24
B. Aires	Fair	29
B.ham	Fair	11
Bangkok	Fair	34
Barcelona	Fair	14
Beijing	Sun	7
Belfast	Shower	8
Belgrade	Shower	7
Berlin	Rain	6
Bermuda	Shower	21
Bogota	Shower	20
Bombay	Sun	34
Brussels	Cloudy	9
Budapest	Fair	3
C.hagen	Cloudy	5
Cairo	Fair	19
Caracas	Fair	28
Cardiff	Shower	10
Casablanca	Shower	15
Chicago	Sun	7
Cologne	Fair	8
Dakar	Sun	25
Dallas	Shower	21
Delhi	Fair	27
Dubai	Cloudy	27
Dublin	Shower	9
Dubrovnik	Sun	12
Edinburgh	Shower	7
Faro	Fair	18
Frankfurt	Fair	7
Geneva	Fair	5
Gibraltar	Shower	18
Glasgow	Shower	7
Hamburg	Drzzl	7
Helsinki	Snow	-3
Hong Kong	Fair	25
Honolulu	Sun	28
Istanbul	Shower	8
Jakarta	Shower	30
Jersey	Drzzl	10
Johannesburg	Fair	26
Karachi	Fair	29
Kuwait	Fair	20
L. Angeles	Sun	16
Las Palmas	Fair	20
Lima	Fair	28
Lisbon	Sun	17
London	Drzzl	12
Luxbourg	Fair	5
Lyon	Fair	10
Madeira	Shower	17
Madrid	Sun	16
Majorca	Fair	17
Malta	Fair	17
Manchester	Shower	9
Manila	Fair	30
Melbourne	Fair	24
Mexico City	Fair	25
Miami	Sun	25
Milan	Sun	12
Montreal	Sun	-2
Moscow	Snow	-1
Munich	Fair	6
Nairobi	Sun	30
Naples	Fair	15
Nassau	Fair	26
New York	Cloudy	4
Nice	Sun	13
Nicosia	Fair	18
Oslo	Sun	3
Paris	Cloudy	10
Perth	Sun	37
Prague	Fair	4
Rangoon	Sun	34
Reykjavik	Snow	-2
Rio	Shower	31
Rome	Sun	14
S. Frsco	Sun	19
Seoul	Shower	11
Singapore	Fair	32
Stockholm	Sleet	1
Strasbourg	Fair	7
Sydney	Shower	23
Tangier	Shower	19
Tel Aviv	Fair	18
Tokyo	Fair	11
Toronto	Sun	05
Vancouver	Shower	8
Venice	Sun	10
Vienna	Sun	6
Warsaw	Snow	1
Washington	Fair	7
Wellington	Shower	22
Winnipeg	Sleet	5
Zurich	Fair	5

FINANCIAL TIMES
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INSIDE

COMPANIES IN THIS ISSUE

MARKET STATISTICS

Microsoft and eBay in 'piracy' row

Software giant angry over rising online sales of counterfeit programs

By Louise Kehoe in San Francisco

Microsoft, the world's largest software producer, and eBay, the US internet auction company, have clashed over the sale of pirated software on the eBay website.

The site has become a marketplace for the sale of thousands of counterfeit copies of software programs. Microsoft is demanding that eBay, whose stock price has risen almost sixfold since an initial public offering in September, takes responsibility for transactions on the site.

More than 6,000 copies of the latest version of Microsoft's Office software were being offered for sale in at least 140 separate eBay auctions this week.

Most sellers were offering the program for $19.99, compared with the $599 for genuine copies of the same software at Microsoft's own online shop.

Microsoft said "test purchases" by its anti-piracy group suggested that many of the programs were illegal, "pirated" copies. It is to launch an "extensive monitoring effort" to identify sales of counterfeit programs and and to seek an end to the auctions.

eBay said it took the issue of counterfeit software sales "very seriously" and would continue to work with companies such as Microsoft "to develop the internet's most comprehensive methods of dealing with these issues".

Computers, software and related products form one of the busiest segments of the auction web site.

eBay recently established a "legal buddy" system through which "content owners" such as software and music publishers can notify it if they find counterfeit goods being sold. eBay then ends the offending auctions. But it disclaims responsibility for what is being sold.

Nancy Anderson, a senior corporate attorney at Microsoft, said the sale of pirated software via the internet had become a "serious problem... Auction web sites, like any endeavour must take responsibility for the goods that are for sale".

Microsoft was "examining all of its options", which might include legal action, Ms Anderson said.

"Our initial effort will be to co-operate with eBay to identify and take down auctions of counterfeit products, but it may be that this marketplace is sufficiently difficult to police that we will need to work on other options."

Sales of allegedly counterfeit software are the latest in a series of controversies to have hit eBay. Last week the company announced plans to end sales of guns and ammunition on its web site.

Earlier this week the National Consumers League, a consumer advocacy group, reported a sharp rise in complaints about fraud on the internet. Online auction transactions accounted for 68 per cent of all fraud reports.

The increase in fraud reports, which rose sevenfold last year as online sales grew sharply, is also of concern to internet industry analysts who point out that consumer trust is vital for the continued growth of e-commerce.

Iridium in danger of breaching banking agreements

By Christopher Price in London

Iridium, the US group which last November launched the world's first hand-held mobile satellite phone service, is in danger of breaching its banking covenants and is seeking talks with bankers to restructure its debts.

Ed Staiano, chairman, said yesterday: "There is a possibility that we may not meet our [covenant] targets." He blamed a technical problem with the handsets and lacklustre marketing by many of its mobile partners for poor sales and revenues. He said the operational difficulties had set back Iridium's business plan by six to nine months, but it was "highly unlikely" the company would go bankrupt.

"I think our banks and investors are very understanding of the situation and we have done everything to keep them informed of what has been going on," he said.

Iridium, which spent $5bn building its satellite system, owes some $800m in secured debt to a small consortium of banks, including Chase Manhattan and Barclays. This is dependent on the company hitting agreed revenue and subscriber targets by the end of March. A further $750m is guaranteed by Motorola, Iridium's parent company until it listed on Nasdaq in 1997. There is also several hundred million dollars of high-yield debt.

Iridium's two rivals, Globalstar and ICO Global Communications, both hope to launch their services over the next two years, but are also reliant on debt markets and investors to raise the billions of dollars needed to build their systems.

Mr Staiano blamed "inertia" among Iridium's service providers as the main cause of the poor performance so far. The Washington-based group has signed agreements with dozens of telecoms groups to use their terrestrial networks as part of the Iridium system and to market the service. However, many have proved reluctant to do this. Mr Staiano said this was due in part to the high cost of the handset, which is as much as $3,600 in the US.

Iridium shares came to the market in June 1997 at $22.25 and hit a high of $70.69 in May last year. However, this week they have sunk to around $28.

Airbus suffers operating loss of $200m

By Alexander Nicoll and Michael Skapinker

Airbus Industrie, the European civil aircraft consortium, made an operating loss of about £125m ($200m) last year because of a price war with Boeing of the US.

The loss was revealed by British Aerospace, which has a 20 per cent stake in Airbus, as it reported that its own pre-tax profits, excluding exceptional items, rose 14 per cent in 1998 to £882m compared with £599m in 1997.

The disclosure was the first indication of financial results of the 29-year-old Airbus consortium and is likely to increase pressure on its partners to change its structure from a Groupement d' Intérêt Economique, a French legal construct, into a corporate entity. BAe said its share of the loss by the Airbus consortium was £25m, but that it had made a profit manufacturing Airbus wings. Partly reflecting concerns about Airbus, BAe shares fell 21p to 420p.

Airbus and Boeing, which dominate the airliner market, have seen a boom in orders in recent years but acceleration in production rates, coupled with cut-throat pricing, pitched Boeing into manufacturing problems and its first annual loss in 1997.

Even if Airbus makes a loss, partner companies – the others are Aerospatiale of France, DaimlerChrysler Aerospace of Germany and Casa of Spain – can achieve a profit through the price at which they sell components to the consortium.

Airbus said it believed if the partners' profits were taken into account, the system as a whole was profitable last year.

However, Mike Turner, BAe executive director, said negotiations to turn the consortium into a limited company were stalled.

BAe's sales were little changed last year at £8.61bn (£8.55bn). Its order book rose 27 per cent to £28.1bn.

The company revealed Saudi Arabia had made a top-up cash payment of about £1bn under the Al-Yamamah weapons contract, to make up for the low price of oil in which payments are usually made.

John Weston, chief executive, said oil price levels made it unrealistic to expect Riyadh to order new aircraft for some time, but he was pleased with the Al-Yamamah contract.

George Rose, finance director, said he expected a definitive agreement to be signed within the next month with General Electric Company on BAe's £7bn purchase of GEC's Marconi defence subsidiary.

The agreement, finalising the accord announced January 19, will set in motion scrutiny by regulators in London, Brussels and Washington.

Mr Weston said in spite of the all-British Marconi deal BAe still planned to take part in consolidation of European defence companies.

BAe's results were affected by a £288m exceptional profit arising mainly from a £368m gain on the sale of most of its stake in Orange, the mobile telephone concern.

As a result, overall pre-tax profit rose to £978m (£533m). The company proposes a 4.15p final dividend, making a total 6.8p, a 33 per cent increase.

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US Treasuries sell-off continues

Investors fear Fed will raise interest rates

By John Labate in New York

Investors sold US Treasuries for the third day running yesterday on renewed fears that the Federal Reserve's next move will be to raise short-term interest rates.

"The bond market has finally woken up to the fact that the economy is stronger than most people thought at the start of the year," said Ian Shepherdson, chief US economist at research group High Frequency Economics.

By early afternoon, the price of the 30-year Treasury bond had plunged 2¼ to 94¾, sending the yield up to 5.652 per cent, its highest level since last August. On Monday, the bond yield stood at 5.365 per cent.

Early weakness in bonds triggered a widespread sell-off in equities, with the Dow Jones Industrial Average down 125.56 points, or 1.34 per cent, to 9,274.11 in the early afternoon.

On Tuesday, bond prices began tumbling in response to comments made by Alan Greenspan, Federal Reserve chairman, in his semi-annual Humphrey-Hawkins testimony to Congress. Traders focused on a reference to last year's interest-rate cuts, concluding that the Fed could raise rates in the next several months.

"His assertion that the Fed needs to evaluate the full extent of policy easing from last year does introduce the notion of a potential interest rate firming down the road," said Kathleen Stephansen, senior economist at Donaldson, Lufkin & Jenrette.

Enthusiasm for bonds was further eroded on Wednesday by a weak response to an auction of two-year notes. Fears of repatriation by Japanese investors also damped sentiment.

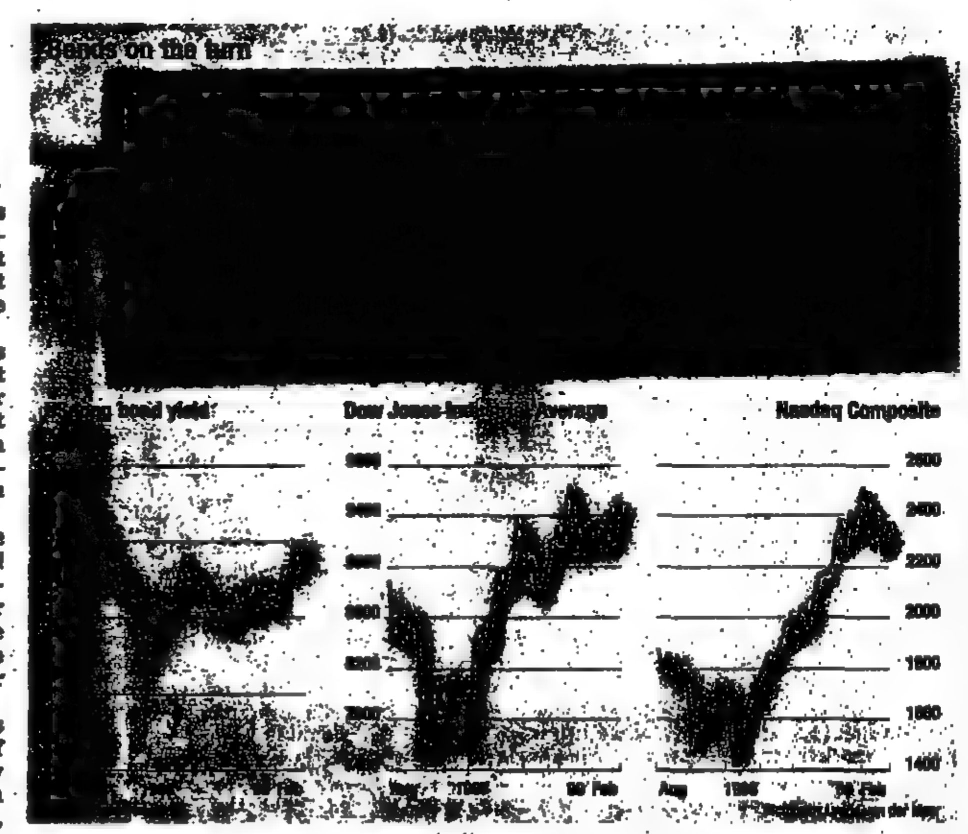
Analysts said yesterday that they expected the bond yield to remain in the 5.8 per cent to 5.4 per cent range in the near term. Recent sharp cuts on Treasury supply as a result of the US federal government's surplus have placed a ceiling on even higher yields.

More is at stake in the stock market, however. The robust comeback in US stock prices from October's lows is largely considered a response to the Fed's three rate cuts.

Rising long-term bond yields in recent months are now seen as a significant negative factor for continued high stock prices. "It raises real questions about 1999 earnings," said Hugh Johnson, chief investment officer at brokerage First Albany. "The cost of capital will rise, which is not good for the economy or earnings, and it also means that money will be siphoned out of the stock market and into the bond market."

Based on earnings into the first quarter of 1999, Mr Johnson calculates a price to earnings ratio for the Standard & Poor's 500 of 27.14. He and others consider that level to be overvalued, especially given the prospect of sustained higher interest rates.

Many stock analysts expect a pullback to 8,500 in the Dow in the near term.



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Dresdner Bank lifts loan loss cover to $1.1bn

By Tony Barber in Frankfurt

Dresdner Bank last night surprised investors by revealing that it had substantially increased loan loss provisions in the last three months of 1998 and said its lending operations in former communist eastern Germany had run into trouble.

Dresdner, Germany's third largest commercial bank, said in a statement issued after the close of Frankfurt trading that it had raised loan loss provisions to more than DM2bn (€1.02bn, $1.12bn) for the whole of 1998. This was more than three times the DM600m that Dresdner set aside in 1997 to cover loan risks.

The higher figure for 1998 reflected the bank's extensive exposure to Russia, where the government last August effectively defaulted on its foreign debt.

But banking analysts said they were surprised by the fact that Dresdner had raised provisions in late 1998, since the bank said last November that it had accounted for all known risks in its credit business.

"Net loan loss provisions were substantially increased once again in the fourth quarter of the year to more than DM2bn for 1998," the bank said. "In the context of country risks, provisions were made primarily for the commitments in Russia, but also for a number of other countries (including Brazil) where ratings had deteriorated during the course of the year."

Dresdner did not elaborate on the statement. But Bernhard Walter, chairman, said last October that the bank had a DM3.2bn exposure in the five largest Latin American countries apart from Chile.

Dresdner, which was the only big German commercial bank to report a third quarter loss last year, said yesterday that "specific risks in the east of Germany" were also behind its decision.

It gave no further details, but its statement recalled the example of Germany's second biggest commercial bank, Bayerische HypoVereinsbank, which put aside DM3.5bn last October to cover overvalued property projects in eastern Germany.

HypoVereinsbank, which announced this week that its 1998 operating profit had fallen by 14.2 per cent, was downgraded yesterday by the investment bank Merrill Lynch, which said it wanted to see "some clear signs of improvements in costs and revenues".

Dresdner, which last year wrote down DM240m on its investment in the damaged US hedge fund Long-Term Capital Management, said its overall pre-tax profits had fallen by 7 per cent in 1998 to DM2.6bn. It said it would propose an unchanged dividend for 1998 of DM1.55.

Germany's two other biggest commercial banks, Deutsche and Commerzbank, have already published 1998 results suggesting they emerged in somewhat better shape than Dresdner and HypoVereinsbank from the world's financial upheavals.

JAPAN COMPANIES STRUGGLE AS DOMESTIC DEMAND FALLS AND THE YEN'S STRENGTH HITS EXPORTS

Malaise deepens as profit warnings abound

By Alexandra Nusbaum, Paul Abrahams and Alexandra Harney in Tokyo

The extent of corporate Japan's malaise was underlined yesterday, when a string of companies in a range of sectors issued profits warnings and restructuring programmes, on the back of collapsing domestic demand and the yen's impact on exports.

Mitsubishi Electric, the electrical and electronics conglomerate, warned it would post a pre-tax loss, excluding exceptionals, of Y80bn (US$656m) in the year to March. That compared with a forecast of a Y30bn profit. Net losses would be Y40bn. The group said sales had been hit badly by the yen's appreciation.

The group revealed a Y210bn restructuring charge at the parent company as well as a Y35bn provision for the employee pension fund.

Bandai, the country's largest toymaker, issued a profits warning citing poor inventory management and losses at overseas subsidiaries. Bandai reversed its estimated pre-tax profit of Y500m to a loss of Y7.5bn. The group expected to post a net loss of Y18.5bn against forecast losses of Y4.5bn.

Victor Company of Japan (JVC), warned it would post a net loss of Y8.5bn for the year ending March 1999. The company blamed sluggish *consumer demand in Japan,* as well as weak sales in Russia, Latin America and Asia *due to the high yen.*

JVC said it expected consolidated sales of Y930bn down from previous forecast of Y960bn for the year ending March 1999, but better than last year's sales of Y916bn. The forecast for pre-tax profits, excluding exceptionals, was revised down from Y10.7bn to Y500m, against last year's pre-tax profit of Y8.8bn. The company revised down estimated net income from Y1bn to a loss of Y8.5bn.

A *collapse* in capital investment in Japan, and a larger than expected decline in overseas chemical and power-plant projects hit Mitsubishi Heavy Industries, Japan's largest general machinery manufacturer.

MHI warned earnings before taxes and exceptionals would fall from Y120.5bn to Y43bn in the year to March, on sales of Y2,500bn this year.

Ube Industries said it planned to cut its workforce by 2,000 to 14,000 by March 2002, and shift away from machinery and plant construction to focus on chemical and medical products. The group said pre-tax and net profit would be identical, at Y500m compared with forecasts of Y2bn for the year ending March 1999. This compares with last year's pre-tax profit excluding exceptionals of Y11.8bn and net profits of Y4.4bn.

Indian see-saw tips from public to private

Foreign investors are deserting companies in the public sector after government interference, writes **Krishna Guha**

India's stock markets typically roar with excitement in the days before the government unveils its budget. But not this year.

Markets are flat ahead of tomorrow's budget speech, with foreign scepticism dulling the instinctive enthusiasm of Bombay speculators.

It has been an encouraging start to the year. Foreign investors bought $106m of Indian equities and debt in January – a sharp reversal from 1998, when nuclear tests, market contagion and protectionist policies prompted a $348m outflow of funds.

Foreign buying helped to lift the benchmark BSE-30 index 7.4 per cent from January 1 to 3,281 yesterday. But appetite is limited and stock-specific.

It is a far cry from the heady days of 1994, when foreign funds drove the BSE-30 index to an all-time high of 4,643. Investment themes have changed too.

Foreign investors remain buyers of Indian software stocks and the local subsidiaries of multinationals – mainly in consumer goods and pharmaceuticals – which have consistently outperformed the market.

But attitudes towards the broad mass of Indian industry and finance have gone through several evolutions.

In 1994 foreign investors discovered the private sector. As the market fell, the private sector's flaws became all too obvious: uneconomic scale, too much diversification and a cavalier attitude to corporate governance. Investors turned to the public sector, quoted enterprises (PSE) in which the government was reducing its controlling stake.

These companies were big and focused in core sectors such as telecommunications, banking and oil. Moreover, there was a promising corporate governance theme: the prospect of ever-increasing commercial autonomy.

This prospect seemed assured in 1997, when the then United Front government bestowed the status of *navratna*, or crown jewel, on nine of India's biggest public sector companies. The *navratnas* were promised enhanced freedoms to build world-class businesses.

Today, the crown jewels are gathering dust. Investors are deserting the public sector and subscribing for new privatisation issues only at painfully low prices.

By contrast, there are signs of renewed interest in the private sector – which has sharply outperformed the public sector recently.

Cyclical trends explain little of the difference. Many analysts blame mismanagement of government finances and the stop-go privatisation programme.

This is a liquidity-driven market, said S. Swaminathan, head of the research company Iris. Public sector shares are illiquid, but suffer from a big overhang of stock which could collapse into the market at any time.

Liquidity concerns are reinforced by changing patterns of corporate governance. Confidence in private sector management has increased, faith in public sector autonomy has slumped.

The latest blow came in January, when the government, led by the Bharatiya Janata Party, instructed public sector oil and gas companies to spend large chunks of their reserves buying government-held shares in each other's businesses.

The cross-shareholding plan is a serious negative, said a London-based fund manager.

Since January 1, shares in Indian Oil, Oil and Natural Gas Corporation and Gas Authority of India have each fallen by about 30 per cent.

Investors worry that other companies may have their coffers raided too. "Do not touch any public sector company with cash," said the head of one stockbroking firm in Bombay. He said the creation of the *navratnas* looked in retrospect a high-water mark, rather than a beginning, in government commitment to public sector autonomy.

The United Front government did little to implement its promises before losing power. Today only four of the nine *navratnas* are able to exercise the powers granted to them two years ago – the rest still do not have the independent boards needed to authorise big spending decisions.

The haphazard process of public sector appointments has if anything become even more wayward. VSNL, the international telecoms company, offered privatisation shares to international investors earlier this month without a chairman in office.

There are repeated signs of backsliding on principles of public sector autonomy.

Shares in state-owned banks slumped last year on rumours that the government had ordered management to support troubled steel producers.

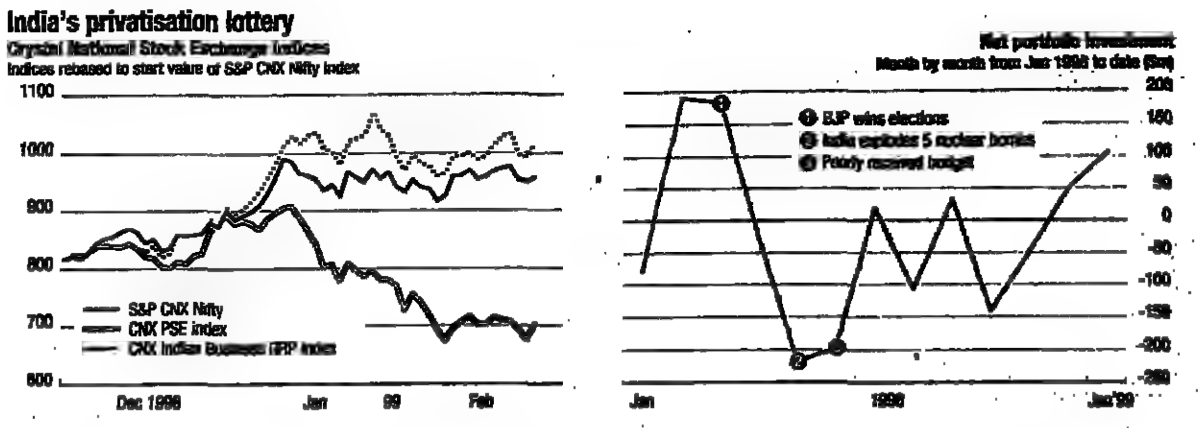
In January, a former finance minister claimed the government was pressuring the same banks and insurers to bankroll privatisation issues. Meanwhile, private sector industry is becoming increasingly shareholder-friendly, ditching old habits of empire-building for a more value-driven approach.

Restructuring is happening slowly, said Jyotivardhan Jaipuria, strategist at DSP Merrill Lynch. But private sector outperformance is constrained because it operates mostly in depressed commodity businesses – while the public sector offers more defensive plays.

A lot of restructuring is happening in industries that are not doing well, said Mr Jaipuria. You still may not see earnings growth.

However, some foreign investors are already buying India's private sector story, ahead of a turn in the commodity cycle. If global prices firm, others are likely to join them.

India's privatisation lottery



NEWS DIGEST

CONGLOMERATES

First Pacific announces management reshuffle

First Pacific, the pan-Asian conglomerate, yesterday unveiled a top-level management reshuffle triggered by the departure of Soedono Salim, head of its biggest shareholder group.

Mr Salim, a member of the Salim group of Indonesia, is stepping down to pave the way for management changes that will focus on core businesses. Taking up the reins is Manuel Pangilinan, First Pacific's managing director, and chief executive of Philippines Long Distance Telephone.

Mr Pangilinan began to restructure the company a year ago, selling off non-core assets and acquiring telecommunications and food businesses.

Meanwhile, the Salim Group has been reducing its stake – reflecting broader problems triggered by the Asian financial crisis – and yesterday both Mr Salim and a fellow director and founding investor quit the board of directors of First Pacific. They will both serve as advisers to the board. Thomas Yasuda, First Pacific executive director, replaces Mr Pangilinan as managing director.
Louise Lucas in Hong Kong

TOKYO-MITSUBISHI

Bank in headquarters deal

Bank of Tokyo-Mitsubishi announced yesterday that it planned to sell half of its Tokyo-based headquarters to Mitsubishi Estate company, a related company, for Y100bn (US$820m) in a sale-and-leaseback arrangement. The move is intended to boost BTM's capital position before the end of the financial year on March 31, the bank said.

Unlike the other large Japanese banks, BTM does not intend to apply for public funds to boost its capital base, since it believes it has sufficient financial strength. It announced last autumn it would issue around Y240bn preferred shares to related companies and private investors.

Separately, the bank revealed it made £60m ($95.9m) losses in its British securities subsidiary over the last two years. The losses, which have not yet been publicly announced, have arisen from proprietary trading in a range of sectors, particularly emerging markets, according to Juntaro Fujii, BTM director and head of Tokyo Mitsubishi International, the UK securities unit. The losses are the largest ever recorded by the UK group.

Earlier this week, BTM in Tokyo announced it would inject a further £185m of capital into the bank. This will raise TMI's capital base to £335.5m after the losses have been accounted for, he said. **Gillian Tett, Tokyo**

THAILAND

Generator moves to profit

Electricity Generating, the listed power producer unit of the state-owned Electricity Generating Authority of Thailand, said yesterday it recorded a net profit of Bt6.1bn (US$162m) in 1998, compared to a net loss of Bt5.5bn the year before.

The swing was due largely to a foreign exchange gain last year of Bt8.1bn, compared to a foreign exchange loss in 1997 of Bt5.5bn.

Consolidated revenue totalled Bt10.2bn, up from Bt8.9bn in 1997. **Ted Bardacke, Bangkok**

Haseko asks for debt forgiveness

By Naoko Nakamae in Tokyo

Haseko, the Japanese construction group, yesterday revised its plan to ask banks to forgive some Y394.2bn (US$3.23bn) of debt. It will now ask its creditors to forgive Y350bn, while asking them to participate in a Y400bn debt-for-equity swap.

Under the new plan, Haseko's three main banks – Industrial Bank of Japan, Mitsui Trust and Daiwa Bank – have agreed to forgive 58 per cent of their loans, or more than Y180bn, to the troubled builder. Haseko is appealing to 36 other financial institutions, including banks and life assurance companies, to also forgive a portion of their loans.

Haseko said it will not be asking the recently nationalised Nippon Credit Bank or Long-Term Credit Bank to participate.

Haseko said it was optimistic its creditors would forgive the full amount, as the figures were drawn up amid extensive negotiation with these institutions.

There is no fixed deadline, although the group will be hoping the talks will be resolved in time for the year end on March 31.

The move highlights the scale of the debt problems dogging the construction sector. Last year, Aoki, a medium-size construction group received Y200bn of debt forgiveness, but JDC, another constructor, was forced into bankruptcy.

Haseko pledged in December to implement a 15-year restructuring programme, which will repay Y315.5bn of debt through sales of affiliated property assets. It will withdraw from all overseas operations and cut its workforce by 20 per cent.

Yesterday, Haseko's share price closed up Y8 or 17.78 per cent at Y53.

Malayan Banking group net profits drop by 40%

By Sheila McNulty in Kuala Lumpur

Malayan Banking, or Maybank, Malaysia's biggest bank, reported a 40 per cent drop in group net profit to M$277.4m (US$73m) for the six months ended Dec 31, 1998.

Net profit at the bank fell 27 per cent to M$327.9m.

The results were among the best achieved in a financial sector battered by economic recession. The bank's risk-weighted capital ratio stood at 13.84 per cent and, at the group level, the ratio was 12.72 per cent – safely above the international minimum requirement of 8 per cent.

"The group's financial strength remains sound despite the economic downturn," said Amirsham A. Aziz, Maybank managing director.

The only fear analysts have had about Maybank is that, because of its solid standing, it would be pressured to do more to pick up the slack of less-fortunate Malaysian banks that are struggling through the downturn.

The authorities are attempting to rescue all the institutions through the purchase of non-performing loans while, at the same time, pushing the banks to lend further still to revive the economy.

Economists fear banking system NPLs could peak this year at 30 per cent of all loans, though Maybank's should be far less.

The bank's net NPL ratio was 3.7 per cent in December, compared to 3.2 per cent in June, and the group's rose to 5.2 per cent from 4.5 per cent.

The bank has 93.6 per cent provisioning cover, and the group has 76.6 per cent, excluding collateral value.

Loan loss and provisions charged at the group level during the period amounted to M$1.27bn, versus M$815.7m in the year-earlier period. At the bank level they were M$852.9m versus M$483.1m.

Maybank expects its prospects to improve during the second half of the financial year.

Economists say there are early indications that the recession might be bottoming out though they are waiting for more conclusive data to be sure.

Maybank announced that it had received approval to merge its finance company in Singapore, Mayban Finance (Singapore), with the Singapore operations of Maybank.

The group wants to consolidate its Singapore operations to better utilise its resources.

AUTO GROUP FORMER DAIMLER-BENZ SHAREHOLDERS TO GET HIGHER PAYMENT AFTER FIRST PRESENTATION OF JOINT EARNINGS

DaimlerChrysler venture drives profits

By Uta Harnischfeger in Frankfurt

DaimlerChrysler, the US-German automotive group, announced a 29 per cent rise in full-year net profit yesterday, backing up earlier pledges that the recently created automotive giant would deliver increased sales, profits and stronger synergies.

DaimlerChrysler said its net 1998 profit excluding extraordinary items rose to €5.22bn from €4.06bn ($5.72bn from $4.45bn) in 1997. It proposed to pay shareholders a DM4.60 dividend, which would mean a significantly higher pay-out for former Daimler-Benz shareholders and a pay-out at previous levels for former Chrysler shareholders.

1998 earnings were broadly in line with analysts' expectations. Operating profit was up 38 per cent at €8.59bn from €6.23bn in the year-earlier period. Earnings per share rose 30 per cent to €5.58 from €4.26 in 1997. It was the first time for DaimlerChrysler to present joint earnings.

Sales rose 12 per cent to €131,782 from €117,572 in 1997, but the figure had already been hinted at during the Detroit car show last month.

The 1998 data also reflected the strong US economy and a record year for German car production. However the somewhat uncertain future of the industry may have been reflected in a 4.2 per cent drop in DaimlerChrysler's shares to €91.40 by mid-afternoon yesterday. They closed down €3.75 at €97.65.

On Tuesday, rival car maker Volkswagen painted a bleak picture of the international car industry.

Nevertheless, analysts remain optimistic about the US car industry, which is so far showing few signs of a slowdown. In Germany, meanwhile, analysts foresee a "natural" slowdown in 1999 from particularly high production levels in 1998.

Analysts say the main question is whether DaimlerChrysler can fulfil its pledge to create large synergies, expected at an annual DM3bn-DM5bn (€1.5bn-€2.5bn, $1.7bn-$2.8bn), in three to five years.

For 1999, the US-German car maker has pledged to create a gross $1.4m in synergies. "From now on, we will be looking very closely where and how soon DaimlerChrysler will create those synergies," said Alice Kytka at Deutsche Genossenschaftsbank in Frankfurt.

Analysts are waiting for any signs that DaimlerChrysler is reaping savings from joint purchasing and common use of components and that it can boost sales.

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LVMH reacts to Gucci's share issue

By Alice Rawsthorn

LVMH, the French luxury goods group, has stepped up the pressure in its battle to control Gucci by asking a Dutch court to freeze the voting rights on the huge block of shares issued last week by Gucci's board.

Gucci, which is quoted in Amsterdam and advised by Morgan Stanley, used an obscure provision in Dutch law to issue 20m new shares to a new employee share *option plan*.

The manoeuvre was intended to prevent LVMH, which had secretly purchased the same number of shares, representing 34.4 per cent of Gucci's original share capital, from controlling Gucci without mounting a full bid.

The French group described the share issue as "preposterous". Advised by Goldman Sachs, it is seeking an injunction to freeze the voting rights on the shares, and then to rescind the issue, by alleging that it infringes the spirit of Dutch law. Gucci said it would "vigorously" defend the "necessary, appropriate and lawful" share issue.

LVMH hopes the Amsterdam Court of Appeal will deliver its ruling before an extraordinary meeting of Gucci shareholders likely to be held in late March. The meeting was called by LVMH two weeks ago to vote on the proposed appointment of a nominee to Gucci's board.

However, LVMH has abandoned its attempt to persuade the New York Stock Exchange to delist Gucci. Last week, it wrote to the NYSE asking if Gucci had breached a rule whereby quoted companies must secure waivers before increasing their share capital by more than 20 per cent. Any company in breach of the rule can be delisted.

LVMH admitted yesterday that it had subsequently discovered the rule only applies to US companies, and not to foreign ones such as Gucci.

At present, Bernard Arnault, LVMH's chairman, appears determined to continue the fight, rather than being pressurised into making a full bid.

Gucci's shares slipped by 5 cents to €63 in Amsterdam yesterday, against €56.90 on the day of the share issue. LVMH's shares were static in Paris at €198.

Rome names advisers on Telecom Italia

By James Blitz in Rome and Paul Betts in Milan

The Italian Treasury announced last night that it had appointed Morgan Stanley, the US investment bank, and N.M. Rothschild of the UK as advisers on the sale of its 3.4 per cent stake in Telecom Italia.

The move is the latest indication that the Treasury wishes to carry out a speedy sale of its stake and be as independent as possible in the brewing takeover battle between Olivetti and Telecom Italia.

The ministry of telecommunications said yesterday that it hoped to come to a speedy regulatory judgment on the sale of Olivetti's telecommunications interests to Mannesmann in the latest development in the takeover move for Telecom Italia.

Olivetti workers in Turin protest against their company's move AP

As Olivetti signed the contract to sell its telecommunications assets to Mannesmann of Germany for L14,750bn (€7.6bn, $8.3bn), the ministry said it would have to rule on the sale on competition grounds.

Salvatore Cardinale, the communications minister, said the judgment would be "as rapid as possible given the delicate profile of the entire situation before us".

As the Telecom Italia board met in Milan to consider ways in which it could respond to a reformulated takeover plan, Olivetti pressed ahead with the sale of its stakes in Omnitel and Infostrada. This revenue is one of the main planks in its €52.55bn plan.

Consob, the stock market regulator, asked Olivetti yesterday to provide full details of the sale. Olivetti's reformulated bid for Telecom Italia, announced in the early hours of yesterday, is now expected to be at the centre of a new legal battle between the two camps.

● Standard & Poor's, the rating agency, surprised some in the markets yesterday when it said it would award the combined Olivetti/Telecom Italia merged company a relatively high credit rating of A minus, writes Edward Luce.

The judgment, which the agency said was based on an unaudited reading of Olivetti's accounts, will be seen as supportive of Olivetti's bid for Telecom Italia. Much of the $49bn debt involved in the takeover would have to be refinanced in the bond markets, which are highly sensitive to credit ratings.

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Mobile phones lift Telefónica results

By Tom Burns in Madrid

A surge in profits at its mobile phones arm helped Telefónica offset the impact of deregulation on its fixed-line business in Spain and heavy provisioning for Latin America, where the Spanish telecommunications company has extensive interests.

The group boosted 1998 attributable net profit 14.5 per cent to Pta217.5bn (€1.3bn, $1.5bn), in line with forecasts, under increasingly unfavourable conditions. In 1997, Telefónica reported an 18.6 per cent increase in net income.

Net income from Telefónica's mobile unit nearly tripled from the previous year to Pta80.3bn, representing 36.9 per cent of the group's profit total, against 15 per cent in 1997.

Telefónica, which has about 70 per cent of Spain's fast-growing cellular market, gained an additional 1.7m mobile users last year, double the 1997 total of new subscribers.

In contrast, earnings from fixed-line operations in Spain grew by just 2.9 per cent last year, from 9 per cent in 1997. Last year was the first in which Telefónica has faced competition from a second carrier in fixed-line telephony. The contribution of the fixed-line business to total group earnings dropped from 62 per cent to 48.6 per cent year-on-year.

The group also took extraordinary charges of Pta130.3bn, against charges of Pta69.4bn in 1997, to cover the worsening financial climate in Latin America, where it is the largest international operator. These bad debt provisions, mainly concentrated in Peru, slowed operating profit growth to 3.3 per cent, but were partially offset by lower payments to minority shareholders.

"The market has discounted the Latin American impact and the main parameters of Telefónica's business are good," said Luis Prota, telecoms analyst at AB Asesores, the Madrid financial services group. Telefónica shares closed up 28 cents, or 0.67 per cent, at €42.35 in Madrid.

Telefónica has embarked on a dual strategy to recover its basic telephony earnings in the face of competition, reducing its payroll and pressing regulators for a rebalanced tariff structure.

BELGIAN ENERGY IMPATIENCE AT LACK OF NEWS ON STRATEGY

Dignified silence on Tractebel

By Neil Buckley in Brussels and Samer Iskandar in Paris

An unrepentant Gérard Mestrallet, chief executive of France's Suez Lyonnaise des Eaux, said yesterday he was happy that his group's row with the chief executive of Suez's subsidiary Tractebel had ended "in dignity".

But he refused to comment further on Wednesday's resignation of Baron Philippe Bodson, saying only that the media had focused too much on an alleged personality clash between himself and the Tractebel chief.

At a conference on Suez's plans for communicating better with small shareholders, Mr Mestrallet also declined to detail his strategy for the Belgian energy group – despite impatience among analysts and investors.

The departure of the gifted maverick Mr Bodson, who fiercely guarded his independence, clears the way for Suez Lyonnaise to shape Tractebel according to its own designs.

So far, it has only dropped *hints – via Tractebel's com*muniqué announcing Mr Bodson's departure – of its intentions. First, Suez made clear it would make Tractebel, already the world's third-largest independent power producer, into the "pole" of its "global ambitions in the energy sector".

Second, it planned to retain the majority control it gained after buying an extra 25 per cent of Tractebel from Baron Albert Frère, the Belgian financier, in 1996.

Finally, Tractebel's partly owned electricity and gas subsidiaries, Electrabel and Distrigaz, previously confined largely to the Belgian market, would be allowed to expand elsewhere. A "far-reaching" industrial plan would "propose the means of achieving this in practice".

Analysts seized on the last comment as a hint that Suez would eventually merge Tractebel with its subsidiaries. Otherwise, the former Belgian electricity and gas *monopolies could end up* competing internationally with their parent.

"The current half-way situation cannot go on for too long," said Eric Ravary, utilities analyst at Crédit Lyonnais *Securities in Paris*. "Deregulation in the EU electricity market reinforces the case for a merger of Tractebel, Electrabel and Distrigaz."

Such a move would be tinged with irony, since the idea was championed by Mr Bodson, and was one of the causes of his clash with Mr Mestrallet.

That was probably because Mr Bodson envisaged the merger in a form that would dilute Suez Lyonnaise's 50.3 per cent Tractebel stake. And as it has made clear, Suez wants to retain a majority.

There are ways the French group could achieve both. One would be to take 100 per cent of Tractebel through a share swap – in the same way it increased its stake *last year in Société Générale* de Belgique, the Belgian holding company which is the vehicle for its Tractebel stake – from 64 to 100 per cent.

If it then merged Tractebel with the two *subsidiaries*, Suez would still hold more than 50 per cent.

A variant of the plan would involve Suez first increasing its Tractebel stake by merging Elyo, its small French-based energy subsidiary, into the Belgian group, in exchange for Tractebel shares. Mr Mestrallet is thought to have tried, unsuccessfully, to persuade Mr Bodson to buy Elyo.

Having disposed of Mr Bodson, Mr Mestrallet is under pressure to reveal his plans at *Suez Lyonnaise's* next results announcement on April 1. As one analyst warned: "The shares could take a beating if he doesn't make things clear by then."

NEWS DIGEST

BANKING

ABN outperforms with 4.5% increase in profits

ABN Amro, the Netherlands biggest bank, yesterday proved its resilience to emerging-market woes by posting a 4.5 per cent rise in 1998 net profit, beating its own forecast of a flat out-turn. Despite problems in Brazil, the Dutch bank said it was sticking to its annual targets of 12.5 per cent average growth in net profit and a 10 per cent gain in per-share earnings. Net earnings rose to Fl 4.03bn (€1.83bn, $2.00bn) last year from Fl 3.85bn, despite tough times in Asia. Good returns from money market and foreign exchange trading as well as deposits, helped the figures. Jan Kalff, chairman, said the economic situation in Brazil was likely to deteriorate. ABN Amro set aside Fl 250m last year for risks in Brazil and said yesterday it would cut its Brazilian workforce by 8 per cent. The bank's emerging market portfolio tumbled to a Fl 323m loss for July to December, having shown a modest profit earlier in the year. Pre-tax operating earnings rose to Fl 2.76bn in the second half, up 3.5 per cent from the same period in 1997. ABN Amro shares closed down 1.6 per cent at €18.65. **Jeremy Gray, Amsterdam**

BANKING

Den Danske surges 24%

Den Danske Bank, Denmark's largest bank, yesterday reported a 24 per cent rise in 1998 core earnings after bad debt provisions but it issued a cautious forecast for this year. Core earnings after provisions were Dkr3.91bn ($576m), up from Dkr3.16bn the previous year. Provisions for bad and doubtful debts were down 20 per cent to Dkr511m. However, the bank said core earnings may fall this year as an expected slowdown in the Danish economy may lead to higher bad debt provisions. The bank recorded a pre-tax profit on ordinary earnings of Dkr5.24bn for 1998, a 13 per cent increase on the Dkr4.63bn achieved in 1997. But Den Danske, like Unibank, its closest rival in Denmark, saw net profits hit by higher taxation, which brought its net profit for the year down to Dkr3.95bn from Dkr4.30bn a year earlier. **Clare MacCarthy, Copenhagen.**

ENGINEERING

Outlook bleak for MAN

Diversified German engineering group MAN yesterday underlined the slump in German capital spending when it gave a bleak outlook for future orders. Despite a 43 per cent rise in net profits to DM265m (€135m, $148m) in the July-December period, from DM185m, and an optimistic profit outlook for the remainder of its fiscal year, falling exports and industrial equipment investments have caused its incoming orders to fall.

MAN projected a "moderate rise in full-year sales," which implied almost flat sales in the second half. In the first half, sales rose.6 per cent to DM10.92bn, from DM9.34bn a year earlier.
Uta Harnischfeger, Frankfurt

Semtex maker AliaChem suffers for sins of its parent

Robert Anderson on the collapse of holding company Chemapol

The AliaChem company, that makes Semtex explosive, the Czech Republic's most notorious export, is teetering on the brink of collapse after its parent Chemapol Group collapsed last month, threatening the country with its biggest corporate failure.

AliaChem is the principal subsidiary of holding company Chemapol Group AS which went down under a mountain of bank debt accumulated in the expansionist mid-1990s.

The collapse serves as an object lesson on the errors of Czech banks, which themselves now have to be bailed out as they head for privatisation next year.

Chemapol Group was the creation of Vaclav Junek, a multilingual, communist-era manager and reputed one-time spy, who rose to the top of the Chemapol trading company in 1991. It grew to become the Czech Republic's fourth biggest company by revenue.

Mr Junek has been ousted as president of the group and is helping the administrator sort out its tangled finances. He went on a buying spree in the mid-1990s to build a chemicals conglomerate and found support from the predominantly state-owned banks that at the time were falling over themselves – with government encouragement – to lend to aggressive entrepreneurs.

"Maybe we were a little under the influence of the general euphoria but the banks were very happy," Mr Junek recalls.

The project came unstuck in 1997 after a currency crisis pushed up interest rates, doubling the holding company's interest bill to Kc1.2bn ($35.2m).

"Our plans were based on interest rates being stable or even falling," Mr Junek says. "The reality is totally different."

The banks, increasingly cautious ahead of privatisation, refused to extend more credits. At the same time the domestic economy was sliding into recession and exports were hampered by the strong crown.

The new acquisitions were also burdened by environmental costs and the group was slow to restructure to gain economies of scale.

In 1997 the holding company slipped Kc3.87bn into the red, while the group as a whole made a loss of Kc5.85bn on a turnover of Kc33.56bn. Mr Junek expects the holding company to make another loss of around Kc3bn-4bn for 1998.

The big banks became shareholders to guarantee their ever increasing loans but only when it was too late did they try to use this to impose some restraint on Mr Junek.

He was forced to dispose of some of the group's many non-core businesses such as the machinery division and media interests and to accelerate plans to merge four chemical companies into AliaChem, in which the holding company owns 52 per cent.

The banks insisted that Mr Junek hire an Austrian manager, Hugo Sekyra, to head AliaChem and ring-fence it from the rest of the group.

However, Mr Junek sacked Mr Sekyra last October after less than a year and the Austrian later committed suicide after claiming the holding company was siphoning off money from its subsidiary through dubious transfer pricing agreements and by tapping its loans.

This was the final straw. Credit Lyonnais, the French bank, demanded repayment of part of its $60m loan.

Ceskoslovenska Obchodni Banka, the soon-to-be privatised former state trade bank, forced Chemapol, the original trading company, into insolvency in October for a debt of Kc3.5bn. In December it went after Kc800m guaranteed by the parent, swiftly winning a verdict last month that the company was insolvent.

Mr Junek was removed and the company, which is appealing against the insolvency, is now trying to settle debts estimated at Kc5.5bn, more than double its share capital.

The whole group's debt is around Kc20bn, making it one of the country's biggest corporate debtors.

The banks are desperate to rescue AliaChem from the wreckage of its parent, to which it is attached by a web of loans, collaterals and guarantees.

The danger is that if all the creditors press their claims, the subsidiary could be drawn into what is bound to be a long and convoluted process.

"AliaChem is in great danger," says a spokeswoman for Investicni a Postovni Banka, owned by Nomura Securities of Japan.

"There is considerable risk of a domino effect." If so, this would lead to the country's biggest corporate failure, affecting 15,000 workers, a third of the entire chemical sector.

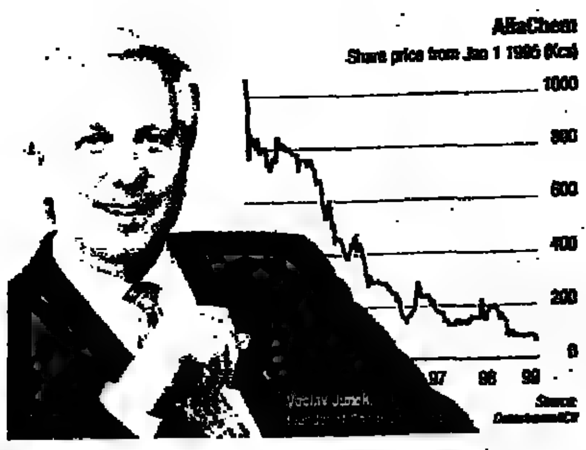
Mr Junek cautions: "AliaChem is working and I hope it can pay back everything it owes. But we must leave it in a quiet place, to give it time to restructure itself."

The banks and shareholders are naturally looking to the state to help them out of their difficulties. So far the Social Democrat government is staying firm and has drawn a distinction between helping individual firms and their tottering holding companies, such as Skoda Plzen, the engineering holding whose chief executive was removed this week.

But Miroslav Gregr, minister for industry, is already pressing for more money to help companies in what is likely to be a year of insolvencies.

Czech taxpayers may end up paying twice for the banks' mistakes – once to bail them out ahead of privatisation, and a second time to help out their most indebted clients.

'The collapse serves as an object lesson on the errors of Czech banks, which now have to be bailed out as they head for privatisation'



Kirch set to take control of Premiere

By John Gapper, Media Editor

Kirch Group, the privately-owned German media group, is close to taking control of the pay television venture Premiere in a move that could lead to the European Commission lifting a block on the enterprise.

CLTUfa, the Luxembourg-based broadcasting group jointly owned by Bertelsmann of Germany and Audiofina of Italy, is thought to be close to selling most of its 50 per cent economic interest in Premiere to Kirch.

People familiar with talks said that the deal was likely to value Premiere at about $1,500 per subscriber.

Since Premiere has about 1.7m subscribers at the moment, this would value the enterprise as a whole at $2.5bn.

If CLT-Ufa reduces its stake in Premiere to 5 per cent, as expected under the deal, it could clear the way for Kirch to operate Premiere as the most powerful pay television service in Germany, closing its own DF1 service.

The European Commission last year blocked a proposal from Kirch and CLT-Ufa for both to raise their stake in Premiere to 50 per cent and for Kirch to transfer its pay television programming rights from DF1 to Premiere.

CLT-Ufa said it could not comment on details of the talks, but confirmed that it was discussing a possible sale with Kirch Group, which has separately been in talks aimed at a financial restructuring.

Mediaset of Italy has been negotiating a possible deal with Kirch along with Prince Al-Waleed of Saudi Arabia and News Corporation, the international media group headed by Rupert Murdoch. Kirch's losses from DF1 has meant that it needs to raise cash from investors.

The German cartel office, which was instrumental in the blocking of the original deal, said it was encouraged by the possibility of change. "We have indications that things are moving in the right direction," said a spokesman.

NEWS DIGEST

PHILIPPINES

Ayala defies Asian crisis to maintain profit growth

Ayala Corp, the blue chip Philippine conglomerate, defied sharp downturns in its core industries of banking and property to maintain profit growth last year.

Ayala Corp's net profit edged up by 2.8 per cent to 6.57bn pesos ($168m) in 1998, despite a sharp fall in profits at its property subsidiary Ayala Land. The 1998 net profit was boosted by net one-off gains of 1.8bn pesos from the sale of shares in Ayala Land.

While the results marked the second consecutive year of static profit growth, analysts said they confirmed Ayala Corp's ability to ride out the Asian economic crisis.

The main drag on profits was Ayala Land, which suffered a 38 per cent fall in net profit to 2.57bn pesos as a result of the depressed property market.

The downturn was cushioned, however, by strong rental income, which contributed 23 per cent of the company's revenues. Its strong financial position was reflected in cash reserves of 6bn pesos and a low gearing ratio of 0.27.

Elsewhere, the Bank of the Philippine Islands, Ayala Corp's banking subsidiary, lifted net profit marginally to 4.6bn pesos in 1998 from 4.5bn pesos, despite an 8 per cent contraction in its loan book to 106bn pesos.
Tony Tassell, Manila

BUILDING MATERIALS

Earnings drop at Pioneer

Pioneer International, the Australian building materials group, suffered a 12.8 per cent slide in net profit to A$119.4m (US$75.4m) in the half-year to December 31 and is forecasting lower earnings for the full year.

The company attributed the fall in interim profit to the fact it had yet to fully re-invest the proceeds from the recent A$400m sale of its petroleum interests by acquiring new quarrying, concrete and asphalt businesses.

Pioneer's earnings in Australia and the US increased strongly, but profits in Europe and Asia were lower. In Europe, Pioneer said it maintained sales volumes but its margins had declined, prompting it to cut capital expenditure and restructure some businesses.
Russell Baker, Sydney

BANKING

Hapoalim to sell holdings

Bank Hapoalim, Israel's biggest bank, said yesterday it planned to sell two non-financial holdings, signalling a continuation of restructuring under a 1996 banking law.

Hapoalim opened talks to sell its 23.7 per cent stake in Ampal American Israel Corporation, an investment company focused on property. Ampal is listed on the American Stock Exchange, valued at $148m, and wants to buy back its own shares. Hapoalim also plans to sell 23 per cent of Poalim Investments, another investment company, valued at $248m on the Tel Aviv Stock Exchange.

According to 1996 banking legislation aimed at reducing concentration in the economy, Israel's biggest banks were required to lower stakes in all non-financial holdings to no more than [illegible] per cent of the company's equity by the end of [illegible] a business perspective, it made more sense for us to sell the entire stake," Hapoalim said.

Hapoalim also said yesterday it would take a $31m charge in the fourth quarter of 1998 for a voluntary retirement programme for 300 staff. Investors are waiting for annual results at the end of March to see how the bank has coped with a continuing economic slowdown.
Avi Machlis, Jerusalem

BANKING SOUTH AFRICAN INSTITUTION DOES BETTER THAN RIVALS DESPITE RISE IN BAD DEBT

Nedcor defies hard domestic market

By Victor Mallet in Johannesburg

Nedcor, one of South Africa's big four banks, yesterday announced a 27 per cent rise in net profit to R1.9bn ($307m) in 1998 from R1.49bn the previous year, in spite of lower interest margins in the difficult domestic market and a sharp increase in provisions for bad debts.

The figures are on a pro forma basis because Nedcor has changed its year-end to December from September. Actual net profit was R2.27bn in the 15 months to December, against R1.43bn in the year to September 1997.

Nedcor said non-interest revenue, which rose 23 per cent to R3.21bn in the pro forma 1998 figures, was helped by good performances from group treasuries and by growth in commissions and fees. Net interest income rose only 10 per cent to R3.92bn.

"We strongly welcome the recent interest rate reductions and anticipate a positive effect on distressed borrowers," the bank said.

Provisions for bad and doubtful debts were raised 37 per cent to R698m as a result of the South African economic downturn and the sharp increase in local interest rates when the rand came under pressure on foreign exchange markets last year.

Earlier this month Standard Bank Investment Corp, a rival banking group, announced a rise in net profit of only 8 per cent to R2.06bn in 1998.

Domestic banking operations improved their profits by 37 per cent, but the bank's international arm lost £31m ($49.6m), largely because of the Russian debt default.

FirstRand, the new group combining the financial services interests of RMBH and Anglo American, including First National Bank, this week reported net profits of R1.14bn in the six months to December.

Nedcor's return on total assets rose to 1.74 per cent from 1.63 per cent, while its expense-to-income ratio dropped to 56.2 per cent from 58.4 per cent.

Stanbic's return on assets fell to 1.4 per cent from 1.5 per cent last time, while its expense ratio improved to 62.3 per cent from 63.4 per cent.

Ayala defies Asian cri
to maintain profit grow

Earnings drop at Pioneer

Hapoalim to sell holdings

Lonely Chevron is in no hurry to join the wedding party

Oil group may have missed merger boat, says **Robert Corzine**

The question of whether the western world's oil industry will be dominated by three or four super-giant companies in the next decade is one that is constantly being debated by oil executives.

Some see such an outcome as a logical conclusion to last year's wave of mega-mergers involving British Petroleum and Amoco, Exxon and Mobil, and Total and Petrofina. They argue that the fittest companies will continue to snap up less competitive ones.

Others, including Sir John Browne, BP Amoco's chief executive, believe there will be scope for companies of all sizes.

For those which have shunned consolidation, the question of whether second- and third-tier integrated oil companies can continue to attract and maintain investor support is of more than academic interest.

Chevron, the San Francisco-based US company, is a case in point. Soon it will be in a lonely – and some would argue exposed – position. Although it will be the second biggest US oil group after Exxon/Mobil, it will be dwarfed by the new energy superpower. But, in turn, its market capitalisation of $51bn is almost double that of Texaco, its nearest competitor.

"We know it's not just a question of market share," says David O'Reilly, Chevron's executive vice-chairman. "We also have to compete for investors' dollars."

That Chevron is alternately seen as a potential target and acquirer reflects its unique position. Late last year Royal Dutch/Shell was reported to have considered a possible takeover of Chevron and there is speculation that BP only just pipped Chevron to the Amoco post. A deal between Chevron and Texaco or other smaller US oil companies is frequently mooted.

Mr O'Reilly is quick to recite the latest oil industry mantra that Chevron would do a deal if "we were confident it would create shareholder value. We're always looking at opportunities to do something in the merger and acquisition area, big or small."

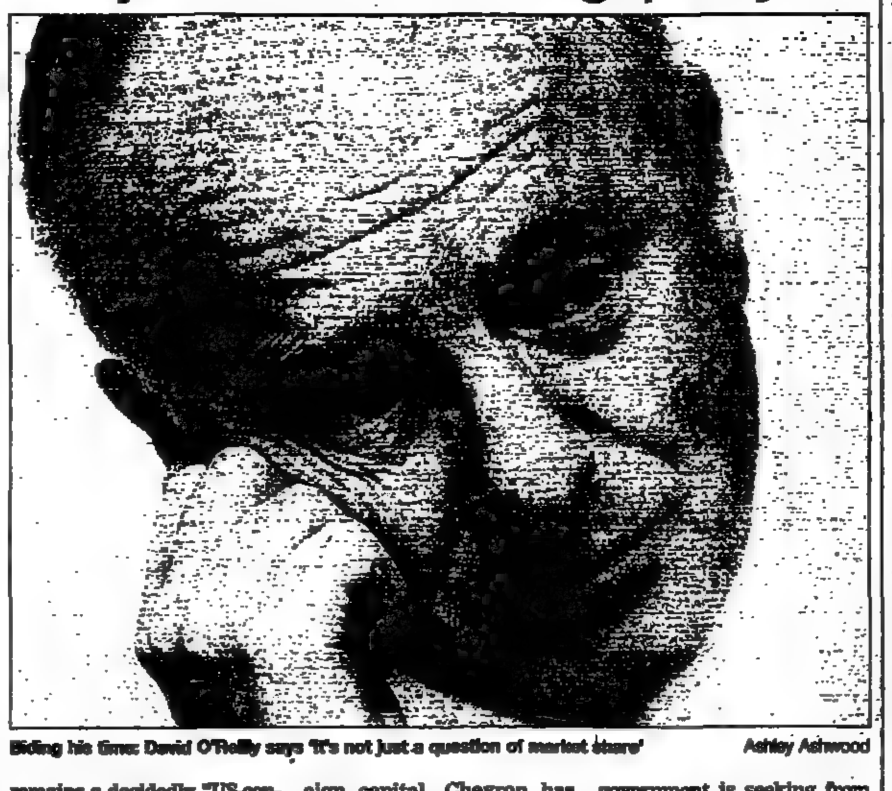
But it is also trying to persuade investors that there is scope for a "value-creating independent enterprise" of a size short of those in the "super league".

Some analysts question whether companies such as Chevron will be at a permanent disadvantage compared with the merged companies, which have promised to deliver billions of dollars-worth of cost cuts and synergy savings. "Is squeezing costs the only way to create value?" asks Mr O'Reilly. "Companies also have to grow the earnings and asset bases. And in the great scheme of things, it is arguable whether Exxon getting bigger will give it more leverage over suppliers."

Chevron's strategy for retaining its independence – and investor interest – rests on several legs. It is midway through a $500m cost-cutting exercise to address the deterioration in trading conditions. The growth element will come from concentrating investment on the international upstream exploration and production sector at the expense of downstream refining and chemicals.

Chevron's bullish view on longer-term oil prices contrasts with some oil men, who fear the crisis marks a downward shift in the fundamental price structure of the industry.

Mr O'Reilly says Chevron is prepared for a three year "oil price siege", although he rejects suggestions that the oil price could be permanently deflated. But confidence that the supply side of the oil price equation will come back into balance is not matched by an equally firm belief in demand trends: "What gives us thought is the demand side of the equation," he admits. "If prices don't come back then we'll have to revisit our plans."



Biding his time: David O'Reilly says 'It's not just a question of market share' Ashley Ashwood

Although Chevron remains a decidedly "US-centric" oil company, it has been among the most ambitious and successful in breaking into difficult developing countries' low-cost oil reserves.

Kazakhstan, Angola and Nigeria feature prominently in the company's investment plans. So too does the Middle East, although Mr O'Reilly is cautious about the speed at which the big Gulf Arab oil producers will open to foreign capital. Chevron has strong historical links to Kuwait and Saudi Arabia.

"In Kuwait I sense the mood is to open up, but there is still some thinking that says it's not a good idea." As for Saudi Arabia, where Chevron drilled the country's first oil well, he says the debate is at "a very early stage", with people outside the kingdom putting "a more aggressive interpretation" of what the Saudi government is seeking from the international oil industry.

But even with more investment opportunities than many of its competitors, Chevron has not been immune to the gloom that has settled over the industry. "Our people are very apprehensive, no question. So maybe it's an advantage that we're not also going through the dislocation of a merger."

CANADA CHANGE OF STRATEGY

Frustrated banks aim for cost cuts

By Edward Alden in Toronto

Canada's largest banks had hoped that this year's annual meetings would be used to introduce shareholders to two new banks that would be ready to expand and compete on a global scale. But with their ambitious merger plans thwarted, the talk instead has been of strategic focus, discipline and cost-cutting.

In December the Canadian government rejected merger plans that would have transformed four of Canada's five biggest banks into two new giants able to compete with the biggest US and European banks.

Ottawa's competition authorities warned that the mergers would severely restrict domestic competition, which was more than enough for the Liberal government to reject the politically unpopular merger plans.

But as John Cleghorn, chairman and chief executive of Royal Bank of Canada, endlessly repeated during the merger debate, the status quo was not an option. Two months after the rejection from Ottawa, the banks are busy rolling out Plan B.

On Wednesday Royal Bank announced that it would cut C$400m (US$267m) in expenses over the next two years and reduce its corporate lending and investment banking activities outside Canada, while bolstering its wealth management and electronic commerce divisions.

Mr Cleghorn said the bank would focus on expanding "higher-return, relatively low-risk business where we have the expertise and potential scale to succeed".

The plan was unveiled one day after Bank of Montreal, its intended merger partner, announced both the resignation of its chief executive Matthew Barrett and a dramatic restructuring plan to decentralise the bank into 32 separate lines of business, with each fighting to demonstrate its worthiness for future investments.

The bank intends to bolster its retail and commercial business lines while narrowing its corporate and investment banking to serve fewer clients in fewer sectors.

Canadian Imperial Bank of Commerce, which saw its earnings plunge last year due to trading losses at Oppenheimer, its New York investment bank, has already reduced staff, quit several lines of business and adopted what outgoing chairman Al Flood called a "very selective, niche-focused" capital markets strategy, concentrating on high-yield debt.

Only Toronto-Dominion Bank, that had intended to merge with CIBC, has escaped relatively unscathed because of its foresight – or luck – to have invested heavily in the discount brokerage business just before the boom in internet stock trading.

Despite Ottawa's rejection of the mergers, the banks are not making these moves out of desperation. With the exception of CIBC, each showed record profits in 1998 and first-quarter earnings for Royal, TD and BoM have been near or above expectations.

But the banks see enough warning signs to avoid complacency. Return on equity, the key measure of performance, began slipping towards the end of 1998, and productivity has not kept pace with the strongest US banks. Analysts say that without the scale to invest in all their lines of business, the banks will have to pick their ground carefully to maintain earnings in the future.

Risk arm buoys broker

Marsh & McLennan, the world's largest insurance broker, yesterday announced a 34 per cent increase in net profits to $796m last year and said prospects for increasing earnings were excellent, writes Andrew Bolger.

Ian Smith, chairman, said the risk and insurance services operations achieved solid organic revenue growth combined with strong earnings. Putnam Investments, a wholly-owned subsidiary, continued to increase profitability. Assets under management exceeded $294bn at year-end, a 25 per cent increase over 1997. Mercer Consulting Group was also said to have had "another very good year".

Mr Smith said the $2bn acquisition last year of Sedgwick, the group's UK-based rival, strengthened its risk and insurance services and consulting operations.

Group revenue rose 20 per cent to $7.2bn and earnings per share increased 26 per cent to $2.98. Fourth-quarter revenue was up 20 per cent up at $1.9bn. Net income increased 30 per cent to $186m and earnings per share grew 30 per cent to 70 cents.

NORMA COHEN
THE PROPERTY MARKET

Pursuing non-rental income

US companies are leading the way to broaden the appeal of real estate investment trusts by using taxable subsidiaries

While the British Property Federation is hard at work lobbying for tax-transparent vehicles similar to US Real Estate Investment Trusts, the US Reits have a new mantra: "Tax us, please."

Why? Because Reit legislation, designed in 1962, is suitable purely for the passive investor in property. And the most successful property operating companies – whether in the US, France or Britain – are anything but passive.

This month, the Clinton administration put forward budget proposals that create the opportunity for Reits to run taxable subsidiaries which carry out a variety of services for tenants, and whose income is from sources other than rent. They would also be allowed to create taxable subsidiaries to engage in third-party management or development activities.

US companies are not the only property businesses seeking non-rental income. Workspace Plc, a UK company specialising in flexible industrial space, has designed packages for tenants for the purchase of insurance and other services, while Capital and Regional, a retail and leisure property company, is looking to earn additional income from the branding of shopping centres.

But the largest US companies have led the way.

Mike Lipsey, chairman of the Lipsey Company, a Florida-based group which advises property companies on strategy, says that companies are increasingly looking to bolster rental income with revenue from the sale of other services. "The big mistake is thinking that the only play in real estate is rent," Mr Lipsey says. "We have a list of up to 100 different services which can be provided efficiently by real estate companies."

Non-rentable space can be converted to storage use or space can be let with high speed internet access at an additional fee, for example.

The new tax proposals implicitly recognise that property companies are in the service sector as well.

The problem is that current rules ban such activities on any significant scale. Maintenance of their tax-free status requires Reits to earn no more than 5 per cent of gross income from non-property sources. That has forced them into a variety of corporate contortions, most significantly the highly-leveraged preferred stock subsidiary which pays interest on an inter-company loan from the parent Reit.

In these, the interest payments are charged off against income, so there is no profit to be reported, a decision which has irritated the US tax authorities and confused shareholders.

It has also blindsided those companies far-sighted enough to realise that there are more ways of extracting revenue than simply raising the rent.

The politics of tax avoidance has weighed on the minds of the industry since Congress revoked some tax advantages for "paired-share" Reits last year, which were the most common exploiters of loopholes.

But the danger of further erosion remains. Sam Zell, the billionaire property entrepreneur whose companies – Equity Office Realty Trust and Equity Residential Realty Trust – have been among the most adept at generating non-rental income, has thrown his weight behind the new tax proposals.

"If passed in some form like this, it would effectively eliminate all of these Rube Goldberg structures that Reits have attempted to use to get around the passivity requirements of the Reit law," Mr Zell said in a recent conference call to clients of Lehman Brothers, the US-based investment bank.

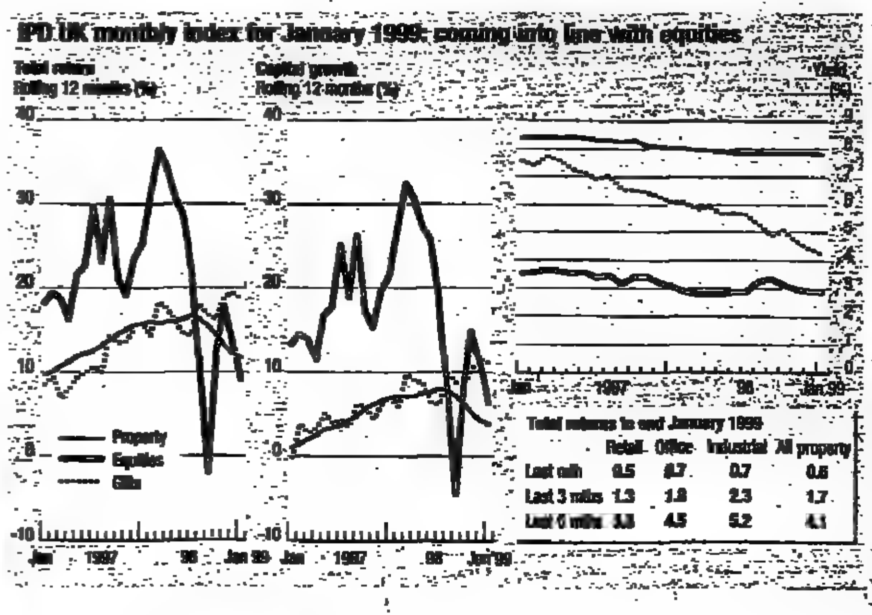
The administration's proposals, which it says will raise $140m (£86m) during five years, create two types of facilities. First, a Qualified Business Subsidiary for non-tenant related income such as third-party management. Second, the Qualified Independent Contractor Subsidiary which may provide an array of services to tenants. Subsidiaries may provide up to 15 per cent of income.

Steve Hash, real estate securities analyst at Lehman Brothers, says the new tax code is a "win-win" proposal.

"Over time, Reits would like to grow to that percentage (of non-rental income) as much as they can," he says.

"It is not just the big companies that will benefit. It is the smart companies. It allows you to make money with your head."

IPD UK monthly index for January 1999: coming into line with equities



Total returns to end January 1999

	Retail	Office	Industrial	All property
Last mth	0.5	0.7	0.7	0.6
Last 3 mths	1.3	1.8	2.3	1.7
Last 6 mths	3.8	4.5	5.2	4.1

Slide halted

A fall in the All-Property yield for the first time since July halted the slide in total returns which began in the second half of last year.

- Over rolling three-month periods, total returns through January held steady at 1.7 per cent.
- In the 12 months through January 1999, property out-performed equities with returns of 11.7 per cent, but badly lagged gilts which returned 18.8 per cent.

From today, IPD data in the Financial Times will be in a format making it easier to compare property performance with other asset classes.

ENTERTAINMENT MTV LEADS GROWTH

Viacom sales surge boosts profits 36%

By Christopher Parkes in Los Angeles

Operating profits at Viacom surged 36 per cent to $296m in the closing quarter of last year as revenues rose across the board, growing 15 per cent to $3.34bn.

The entertainment group said sales growth was led by its MTV network, Paramount Pictures and Blockbuster video rental chain.

Sumner Redstone, chairman and chief executive, said plans announced yesterday for a 2-for-1 share split and the move of the company's listing from the American Stock Exchange to the New York Stock Exchange reflected his optimism that Viacom could sustain its momentum.

Group cash-flow, defined as earnings before interest, taxes, depreciation and amortisation, rose 24 per cent to $502m, although net income of $36.3m fell short of analysts' forecasts, yielding 10 cents a share compared with predictions of 13 cents.

Blockbuster, which is to be spun off in the next few months through an initial public offering, reported an increase in revenues of 20 per cent generating 28 per cent more cash-flow.

Same-store sales rose 15 per cent in the quarter, bolstered by aggressive marketing and a revenue-sharing agreement with film studios.

Paramount and MTV both reported record results, as the film division benefited from the overseas release of *The Truman Show* and *Saving Private Ryan*, its co-production with Dreamworks. *Titanic*, the most successful film and video release on record, also continued to contribute a year after its launch.

Paramount's cash-flow increased 26 per cent to $50m on revenues up 13 per cent at $1.2bn.

Big picture: Saving Private Ryan was a huge success for Dreamworks and Paramount Bandphoto

MTV, named this week to lead Viacom's drive into internet entertainment and commerce, reported a 21 per cent increase in revenues to $617m, and cash-flow up 15 per cent at $252m. The main engines of growth were MTV and VH1, the music-based cable networks, and Nickelodeon, the children's network that is the most-watched cable service in the US.

Consumer publishing, the remnants of a broad-based publishing business reduced by the sale last November of its educational and professional departments, reported revenues up 9 per cent and cash-flow of $36m for a 30 per cent gain.

Revenues for the year, which saw Viacom's stock price almost double to $88%, rose 13 per cent to $12bn, and cash-flow and operating income rose 20 per cent and 31 per cent respectively.

CHILE SPANISH GROUP PLANS AGAIN AFTER DISAPPOINTMENT

Endesa fails to take control of Enersis

By David White in Madrid and Mark Mulligan in Santiago

Endesa, the leading Spanish electricity group, began yesterday to reassess its plans for Latin America after being thwarted in its attempt to establish outright control over Enersis of Chile, up to now its main investment target in the region.

The Spanish group is expected to remain a shareholder in Enersis but to examine alternative investment opportunities in Mexico, Brazil and the US to provide the next stage of its international expansion.

Immediately following its setback in Chile, Endesa announced better than expected 1998 results, showing a 9.5 per cent rise in consolidated net profit to €1.1bn (US$1.2bn) and a 14 per cent increase in earnings per share to €1.10. The figures came after the close of trading in Madrid, where Endesa's share price slid 4.4 per cent to €23.82.

The company said it had asked for a recount of Enersis shareholders' votes after failing narrowly to win the 75 per cent approval necessary for a change in statutes that would have allowed it to bid for majority control. Endesa fell 1 percentage point short of the 75 per cent majority needed to change Enersis's statutes.

Under a plan drawn up with advice from Goldman Sachs, it was offering $1.45bn to buy a further 32 per cent of Enersis. This would have doubled its existing stake, currently the maximum permitted for a single shareholder. It managed to *persuade Chile's powerful* pension funds to back the rule change but failed to win sufficient support from US shareholders.

Outright control would have enabled it to overrule the sale of Enersis's 25 per cent interest in Chile's biggest electricity generator, also called Endesa. Its opposition to the sale plan prompted its bid to assume outright control of Enersis.

The Spanish group has raised the possibility of buying directly into Endesa Chile, saying that if it did so it would make a public bid for at least 25 per cent of the generating company.

It said yesterday it saw scope for co-operation with Duke Energy of US, which last week offered $2.1bn for 61 per cent of Endesa Chile, and would back moves to raise the shareholding limit in that company.

The Spanish company, which was fully privatised last year, bought into Enersis in 1997, seeing the Chilean group as the main platform for an ambitious Latin American investment drive. But its venture has been dogged by controversy and legal disputes.

It has made clear, however, that it has no plan for selling its existing shareholding in Enersis, which accounts for about 40 per cent of its $3.5bn investment in the region. Executives said it was able to block any company from gaining a foothold in Enersis.

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Maseca emerges as a tasty choice

By Andrea Mandel-Campbell in Mexico City

Grupo Industrial Maseca, Mexico's largest cornflour miller and maker of the humble tortilla, has emerged as a tasty stock since the lifting of strict controls on the country's most heavily protected industry.

After two years of falling sales and sagging profits, the prospects for the company are looking up following the government's new year decision to liberalise the tortilla industry.

Maseca, say industry experts and market analysts, is the company that stands to gain most from the ending of a complex chain of subsidies ranging from price caps on the flat corn pancake to production quotas on the cornflour used to make Mexico's staple food.

Owned by Mexican food conglomerate Gruma, in which Archer-Daniels-Midland, the US miller, has a 22 per cent stake, Maseca commands a 70 per cent share of the country's cornflour market. Its production is used to make 44 per cent of all tortillas.

With the removal of production quotas, the miller is aiming to boost the volume of cornflour sales by 16 per cent this year, according to Ricardo Alvarez-Tostado, general director. Gruma, which had sales of $1.1bn in 1997, will invest an estimated $200m in 1999 for new mills, better distribution and more advertising.

But the key to Maseca's strategy of increasing market share is aimed at converting the majority of tortilla mills that still use corn dough – the traditional method of making tortillas – rather than cornflour.

Corn dough is made from raw corn, boiled with water and lime in a process that takes eight hours.

With limits on flour production now lifted, Maseca wants to lure about 3,500 small, family owned mills to produce cornflour, which has a shorter production time and longer shelf life.

But while cornflour may be more efficient than dough, Maseca may have a hard time convincing some tortilla makers to give up the centuries' old tradition.

"You would have to put a gun to my head before I would change to flour," says Felipe Galindo Rojas, who has run his combination dough mill and tortilla factory in Mexico City for the last 52 years. "Companies like Maseca are killing our tradition."

While the transition from a heavily controlled industry to an open market will be slow, Mr Alvarez-Tostado says competition is already fierce.

Since price caps on tortillas were removed, prices shot up by a third to 4 pesos (40 cents) a kilogramme, before public protests forced the industry to agree to 3.5 pesos a kg.

Already some are undercutting the consensus price and many analysts question whether Maseca will be able to maintain its 15 per cent profit margins in the long run now that costs are no longer subsidised.

Once the new market conditions become more settled, Maseca eventually foresees reproducing what its sister subsidiaries in the US and Central America have been doing for years: offering speciality tortillas ranging from low-sodium to chilli pepper flavoured tortilla wraps.

"The possibilities are as wide as your imagination," says Mr Alvarez-Tostado.

Reader's Digest plans big strategy changes

By John Authers in New York

Reader's Digest, publisher of the most widely circulated magazine in the world, yesterday announced a sweeping change in strategy, including an upgrade of its operations on the internet, in a bid to reverse years of declining earnings.

The company will also seek to diversify into product lines that can be sold via direct marketing, including pharmaceuticals and financial services. It will also try to develop new distribution channels, including direct response TV and new forms of direct mail.

Most of this will be done through joint ventures, and the company will also look for acquisitions, particularly of magazine publishers outside the US. However, the company refused to comment on reports that it was negotiating an ambitious joint venture with Time Warner, the media group.

Thomas Ryder, who was brought in as chief executive from American Express last year after the abrupt resignation of his predecessor, said he would also consider an initial public offering for the company's interests "provided the market stays irrational".

The company will invest at least $100m into websites which will be re-branded or co-branded with the Reader's Digest name.

He said the strategy was to focus on the over-50s "baby boom" generation where the company's flagship magazine has its greatest readership. Its new product lines *have been chosen to capitalise* on the strong elements of trust that are carried with the Reader's Digest brand name. These will focus on "home, health, family, finance and faith".

According to Mr Ryder: "The products we are looking to as extensions are trust-based products. People who need to trust a purveyor will find the Reader's Digest name very powerful."

He said that the company expected its revenue to fall over the next year, and that it would then introduce new product lines into a more profitable base. Its internal targets are for revenues of $5bn in 2004 (double its level at the end of last year), and operating profits of between $500m and $600m – a strong increase from the $100m recorded last year.

Next year, it hopes to enter the directly marketed pharmaceuticals business, and is already in discussions with potential partners and acquisition targets. It will also look for financial services, where it will be the branded supplier of products manufactured by partners. Credit cards, retirement savings products and insurance are the most important.

CBS ready to pay premium for rival NBC

By Christopher Parkes

Mel Karmazin, chief executive of the CBS network, reasserted his faith in broadcast television yesterday with an offer to pay a generous premium for rival NBC, should its owner, General Electric, decide to sell.

Speaking in New Orleans, he said he believed GE would eventually dispose of the network, "in which case we'd be willing to overpay for it as much as we overpaid for the NFL".

Last year CBS paid more than double the previous rate for television rights to American football games in a successful bid to win back audiences.

Although Mr Karmazin has expressed interest in NBC before, and GE has said selling the business is a possibility, current federal regulations allow companies to own only one network.

However, Mr Karmazin and other network heads are lobbying in Washington for changes to rules established before cable and satellite emerged to challenge the traditional broadcasters.

Now that CBS, currently the top-rated network, NBC, ABC, Fox, and newcomers WB and UPN share less than 50 per cent of the US audience – and only NBC is profitable – they are demanding action.

Their main objective is to change rules on broadcast TV station ownership which limit any single owner-operator to 35 per cent of the US audience.

Although other network groups are believed to be interested in NBC, Mr Karmazin has been most forthright in claiming his place at the front of the line.

He has also been prominent in recent moves to address concerns within the Federal Communications Commission, the industry's main regulator, that minorities are under-represented in broadcasting.

Mr Karmazin wrote last week to fellow chief executives calling for talks on the issue. Last year News Corporation, which controls Fox, proposed setting up an industry fund to help minorities in return for sweeping deregulation of broadcasting.

That initiative was supported by Chancellor Media, a leading radio group, and Paxson Communications, a small national network launched last year.

Niche retailers surge ahead

By Andrew Edgecliffe-Johnson in New York

The Gap and JC Penney provided further evidence *yesterday of how flourishing* US consumer spending is buoying some specialist retailers while passing by other mid-market stores entirely.

The group behind The Gap, Banana Republic and Old Navy reported a 54 per cent jump in net earnings for 1998 to $824m, but JC Penney, the department store and catalogue retailer, managed just a 5 per cent earnings advance to $594m.

Mid-market department stores including JC Penney, Sears and Dillard have been squeezed as some consumers have sought better value in discount chains such as Wal-Mart while others have traded up to more fashionable branded retailers.

Donald Trott, retail analyst with Brown Brothers Harriman, added that Gap's fourth-quarter 40 per cent sales increase and 46 per cent earnings advance owed as much to its own efforts as to the favourable economic climate.

"It sounds trite, but they do a zillion things right," he said. Gap's decision to step up marketing investment last year from 2.5 per cent of sales to 4.4 per cent, or $400m, also paid off.

JC Penney, by contrast, cited higher advertising spending as one reason for its profit slump, which was mostly attributable to lower *sales over Christmas*, heavy price discounting and restructuring to improve inventory management.

Operating profit from department stores and catalogues dropped by 54 per cent in the fourth quarter to $295m, but its Eckerd drugstores increased profits by 45 per cent to $104m. Full-year group sales were $30.7bn, up just 0.4 per cent.

James Oesterreicher, chief executive, said: "Our 1998 results were not acceptable. Returning the company to higher levels of profitability is our number one priority in 1999."

The group warned in January that earnings would not meet analysts' expectations of about $1.06 per share for the fourth quarter. Yesterday's quarterly earnings of 77 cents a share were above revised estimates of 73 cents, according to First Call, taking full-year earnings to $2.19 ($2.10).

Gap beat expectations by a narrow margin, with quarterly earnings per share of 53 cents, up from 36 cents, lifting full-year earnings by 57 per cent to $1.37. Sales were a record $9.05bn, up 39 per cent on a 22 per cent increase in store space.

COMPANIES & FINANCE: UK

Colt Telecom hopes to raise extra £500m

By Alan Cane and Vincent Boland

Shares in Colt Telecom fell 10 per cent yesterday after the UK operator surprised the City with plans to raise £500m ($815m) in new capital to fund new networks, prompting fears the company was falling behind its competitors.

The news of the issue of equity and convertible bonds denominated in euros cast a shadow over Colt's full year results which were at the top end of market expectations, including a more than 150 per cent increase in sales.

Colt last made a cash call in July 1998 raising £600m which, it said, would be adequate to fund its development until mid-2001. Yesterday it said that had been predicated on the assumption that the business plan would not change. Since late 1997 it has regularly revised upwards the number of European cities it intends to link with its fibre optic network, the total now being 26.

Colt builds fibre optic rings around major financial centres connecting directly to its customers. Now it is planning to link them together with long distance fibre cables.

Paul Chisholm, president and chief executive, said the cash would be used to build these connections using internet technology, to improve the quality of its internet services to its European customers and to expand its local presence in Europe by building small switches ("point-of-presence") in a number of cities.

● Orange, the newest of the UK's four cellular phone groups, moved into operating profit last year as subscriber numbers leapt 80 per cent to 2.16m. Orange has been offering mobile services only since April 1994, writes Alan Cane.

With 5,200 base stations, 25 per cent more than its nearest rival, it claims to have the UK's largest mobile phone network.

However the share price dropped 51½p to 907p yesterday after Hutchison Whampoa, the Hong Kong group which held a 49.01 per cent stake, sold 50m shares, or approximately 4.2 per cent of the equity, through Goldman Sachs for HK$5.28bn ($684m).

Canning Fok, Hutchison Whampoa group managing director and Orange chairman, said the proceeds would be retained for general purposes.

Orange's 1998 results were in line with market expectations. Turnover was 33 per cent ahead at £1.21bn ($1913.7m), while earnings before interest, tax, depreciation and amortisation were £147m (£47m).

The company is a service provider in France and Germany, has opened services in Austria and has licences in Belgium and Switzerland.

Traders suspended in CSFB inquiry

By Jane Martinson in London and Nicholas George in Stockholm

James Archer, the son of Lord Archer, the Tory peer, is at the centre of a share dealing investigation by Credit Suisse First Boston, the Swiss-US investment bank, it emerged last night.

The inquiry which led to the suspension of three traders was understood to have been triggered by Mr Archer's share buying in Stora, the Swedish paper group which merged with Enso of Finland at the end of last year, according to people close to the inquiry.

The Stockholm stock exchange confirmed yesterday that it was investigating suspected market manipulation after several trades thought to be worth a total of Kr10m ($1.23m) in December.

Concerns were raised that the trades would have the effect of moving OMX, the main Swedish share index which is thinly traded.

Mr Archer was suspended by CSFB along with David Crisanti, head of CSFB's London-based index arbitrage desk, and Adrian Ezra last week.

CSFB declined to comment last night until its internal investigation is completed.

Mats Wilhelmsson, head of market surveillance at the Stockholm exchange, said yesterday that it had launched the investigation at the end of last year after spotting certain market irregularities.

The exchange subsequently contacted Swedish and UK authorities including the Securities and Futures Authority, the City watchdog. CSFB representatives have also flown to Stockholm to help in the investigation.

The traders – who specialised in index arbitrage, betting on index price anomolies – had gained notoriety in the City as members of the Flaming Ferraris, a high-living group named after a favourite cocktail.

BA plans further cut in fleet expansion

By Michael Skapinker

British Airways has announced a further cut in its aircraft fleet expansion in an attempt to shore up its profitability. The airline recently announced a first-ever third-quarter loss of £75m ($122m).

Robert Ayling, chief executive, told a meeting of aviation analysts yesterday there would be almost no increase in BA's aircraft capacity in 1999-2000. The year after that, the number of seats would rise by less than 2 per cent and, in 2001-2, aircraft capacity would be cut.

These figures compare with BA's earlier pledge that capacity would increase by no more than 2 per cent annually for the next three years.

BA's shares fell 29¾p yesterday to 453¼p. However, they have risen from a low of 308p in October following Mr Ayling's announcement of plans to increase profit margins.

Mr Ayling also told the analysts the fall in investment in new aircraft meant BA's cash flow would be positive after 2001-2.

Mr Ayling has said he intends to concentrate on selling higher margin business class fares, while offering fewer discount economy tickets. The decision to limit the increase in the number of aircraft is an attempt to reduce the number of seats BA has to sell at the cheaper rates.

By 2002, nearly half of BA's long-haul fleet will consist of smaller Boeing 777s rather than the larger Boeing 747s.

BA also told analysts that it aimed to increase the number of tickets sold over the internet to 50 per cent of bookings by 2003, against a negligible proportion today.

The attempt to take more internet bookings is part of BA's attempts to cut distribution costs. The company has achieved £600m in annual savings since 1996, but wants to cut costs by a further £400m. Mr Ayling has assured BA's 62,000 staff there will be no job losses.

Lifting a corner of BAe's veil of secrecy

Saudi Arabian business has been a mixed blessing, writes **Alexander Nicoll**

The importance of Saudi Arabia to British Aerospace as a source of business is both a blessing and a curse. The Saudi government is a customer of 25 years standing, with which Bae expects to do significant business for many years. Its orders helped the group survive its darkest days in the early 1990s.

But the secrecy that shrouds the 14-year-old Al-Yamamah contract, which BAe administers on behalf of the British government, is a problem. For reasons of customer confidentiality, BAe's figures do not give a clear picture of Saudi orders or their profitability. Speculation about the kingdom's economy and ordering intentions thus tend to have a big influence over BAe's share price, especially when oil prices are low.

Yesterday, BAe lifted a corner of the veil. It revealed that out of an order book which rose 27 per cent in 1998 to £28.1bn, 11 per cent was accounted for by "Al-Yamamah and training services". This means BAe has Saudi orders totalling some £3bn even after completing delivery last year of a batch of 48 Tornado aircraft. The low oil price and cuts in Riyadh's defence budget mean BAe is not expecting any new aircraft orders to be placed for some years.

Al-Yamamah has become, for the time being, mainly a service contract for maintenance and support of 120 Tornados as well as Hawk trainers and defence equipment which BAe and other UK companies have supplied. BAe has 5,500 employees in Saudi Arabia.

BAe includes expected revenue from service activities in the order book one year at a time. This is understood to account for the bulk of the £3bn – and will therefore account for a sizeable chunk of its 1999 sales. Orders for equipment on a smaller scale than aircraft are included as they are received.

After Tornado deliveries were completed, payments made in oil were cut from 600,000 to 400,000 barrels per day. Saudi Arabia also made a cash "top-up" payment of about £1bn, but this did not arrive until early January this year and embarrassingly forced BAe to report a £839m operating cash outflow for 1998. This was a bit of accounting transparency the customer could have done without. It also revealed how dependent BAe still is – at least for cash flow – on Al-Yamamah.

BAe executives emphasised they saw revenue and profits coming from a variety of sources in addition to Saudi Arabia. Al-Yamamah will still be important, but will diminish as a proportion of sales if regulators clear BAe's proposed acquisition of Marconi from GEC.

● First, BAe will make the front fuselage, stabilising fins and first stage of the aft fuselage for 620 Eurofighters, and assemble the 232 aircraft ordered by the UK. Greece's statement of intent to buy the aircraft suggests it has strong export prospects.

BAe is making Nimrod maritime patrol aircraft for the UK, and continues to win orders for Hawk trainers. South Africa recently put in the first export order for the Gripen fighter made by Saab of Sweden, in which BAe holds 35 per cent.

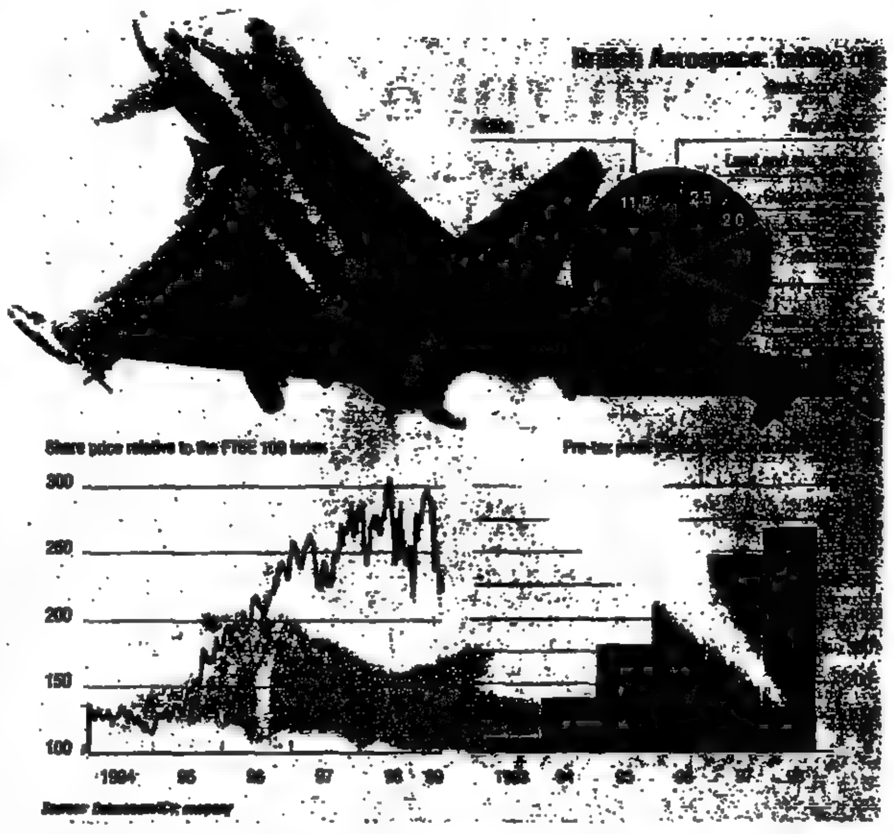
● Second, BAe hopes for a long-term improvement in profit margins at Airbus, especially if restructuring the civil aircraft consortium into a single entity can be agreed with its partners.

Margins would also be improved if Boeing and Airbus, which have sought to undercut each other for years, were to change their pricing policies in order to earn higher returns. In the shorter term, repayments of launch aid will diminish from 2000 onwards and boost BAe's Airbus profits.

● Third, BAe expects to benefit from the UK Ministry of Defence's policy of expecting "prime contractors" to take on more risk and to support weapons throughout their service.

● Fourth, Bae plans to expand its markets. The acquisition of Marconi will give it a substantial electronics business. The group expects its missiles business to grow and is seeking to improve returns from its expanding portfolio of systems activities.

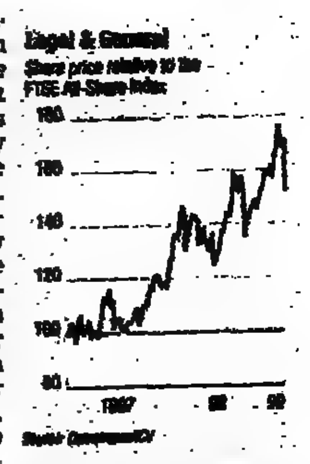
It intends to expand further in the long term through consolidation among European and US arms makers. John Weston, chief executive, said the Marconi purchase would give it greater choice and in spite of German and French chagrin, "virtually all routes are still open".



COMMENT

Legal & General

It had to stop. Legal & General may be a fast grower in one of investors' favourite sectors – life assurance – but 2.6 times book value was over the top. This was nearly twice the value of CGU, the biggest composite insurer. One disappointing figure – net assets 6 per cent below expectations – pricked the bubble. More general concerns about margin erosion did the rest. It is the latter worry that sticks. Although last year was a good one for life and pensions products, competition continued to erode after-tax returns – albeit from high levels. Slower growth in the industry this year could compound this. L&G, a well oiled machine, should still outpace its peers. But a more interesting question lies in the relatively low valuation of composite insurers. With an array of deals bringing discipline to their general operations, investors are beginning to see better value there.



Colt Telecom

Colt is cheeky to ask investors for another £500m just months after telling them its capital raising days were over. But its plans for spending the cash – linking the European cities where it is building local high speed networks – seem sensible. Building inter-city networks should allow Colt to offer more services to customers while cutting its reliance on other carriers to handle long distance calls. The latter has a dual benefit, helping it reduce prices and guarantee service quality. These factors, Colt believes, will help it seize and retain customers.

Nonetheless, the additional investment raises concerns. For one thing, it may dilute the returns investors expect from the £1bn Colt is already investing. It also highlights the competition emerging in the business telephony market. One reason Colt's shares soared so high was because bulls thought it might be bought by a US entrant to Europe. Now rivals like Level 3 are building their own networks.

This all makes life a little more tense for Colt. Even after yesterday's 10 per cent fall, its shares trade at 17 times forecast sales. It can ill afford for its investors to lose heart. At least enthusiasts can still point to the more competitive US market, where stratospheric valuations remain the norm. And Colt has yet to disappoint: quarterly revenues are still growing at a juicy 30 per cent.

L&G shares fall on margin fears

By Christopher Brown-Humes

Shares in Legal & General plunged 12 per cent yesterday on worries over falling margins and a lower-than-expected net asset value.

The 109½p fall to 798p was the worst performance in the FTSE 100 and came despite a 13 per cent rise in operating profits from £228m to £369m, in line with expectations.

Analysts said the shares, which have risen spectacularly in the last four years, were overvalued.

Roman Cizdyn, analyst with Merrill Lynch, said the group's net asset value – the present value of future profits from business on the books – was 349p, against an expected 370p. The shares have been trading at two and a half times NAV, the highest rating of any FTSE 100 life group.

Analysts also pointed to a margin squeeze that reflected tough competition.

Although L&G's UK life and pensions business lifted sales 22 per cent last year, profits from new business fell from £78m to £72m. Moreover, the post-tax return on capital fell from 15 to 11 per cent.

David Prosser, chief executive, said: "The environment for life business going forward is about thinner margins." But he said the group remained confident it could continue to lift volumes and cut costs to offset margin pressures. "We have been growing individual life and pensions business in the UK by 30 per cent a year over the last four years, and I don't see why we can't continue doing that."

Organic growth remained the strategic priority, he said, as L&G only had 5 per cent of the highly fragmented UK market. There were no plans to return surplus capital to shareholders because "we want to use it to build up business and back further growth".

SB signals £5bn buy-back

By Lucy Smy

SmithKline Beecham yesterday held out the prospect of a £4.9bn ($8bn) share buy-back in a move seen by some analysts as shoring up its defences against a possible hostile bid.

The pharmaceuticals group denied that its plan to ask shareholders for the authorisation to buy back up to 10 per cent of shares was "purely defensive" and said it was only to increase flexibility.

The group said: "The authority would last for a year, but it does not mean that we will necessarily use it."

Since the start of last year the group has considered and abandoned two mega mergers, first with American Home Products and then with Glaxo Wellcome. This year, Jan Leschly, chief executive, said the company would stand alone and would not engage in further talks.

However this independent stance has left a number of analysts believing the group is vulnerable to a hostile approach. "If Glaxo wanted to make a move, now would be a good time," said one.

As well as adding the financial flexibility to support the share price, making it more difficult or at least expensive to approach SmithKline, the move would allow the group to offer a sweetener to shareholders.

Two weeks ago, SB set itself a 13 per cent earnings growth target for 1999.

Weak metals prices hit Rio Tinto

By Gillian O'Connor

Rio Tinto, the diversified Anglo-Australian mining group, is heading for a further drop in earnings this year unless metals prices unexpectedly improve.

Most metals prices are now below their average levels for 1998, and Bob Wilson, chairman, yesterday said that despite being close to the bottom, a recovery was not expect until some companies operating high-cost mines cut production.

However, he said from Rio's view as a low-cost producer, it would be good if low metal prices persisted and led to a shake-out of surplus capacity. He estimated 20 to 30 per cent of copper producers were losing money on a "cash cost" basis, and more than 60 per cent on a profit and loss account basis.

Group revenues for 1998 were 2 per cent lower at £5.56bn ($9bn).

Pre-tax profits fell 27 per cent to £910m ($1.27bn)after the predicted write-down of asset values resulting from compliance with UK accounting standard FRS 11.

The copper, aluminium and gold divisions showed lower profits, but iron ore, industrial minerals and energy rose.

RESULTS

		Turnover (£m)		Pre-tax profit (£m)		EPS (p)		Current payment (p)	Date of payment	Corresponding dividend	Total for year	Total last year
Arjo Wiggins	Yr to Dec 31	3,323	(3,421)	211.4	(216.1)	17.7	(18.1)	5.4	May 21	5.1	8.5	8
British Aerospace	Yr to Dec 31★	8,611	(8,546)	973♥	(233♠)	35.4	(8.2)	4.15	June 1	2.93大	6.5	4.88大
Card Clear Φ	Yr to Dec 31	29.6	(7.15)	2.11♠	(1.93)	0.96	(1.99)	0.1725	May 11	0.15	0.2875	0.25
Clarke(T)	Yr to Dec 31	57.2	(52.6)	3.38♠	(2.72)	17.5	(14.7)	5.59	May 10	4.07	8.13©	8.11©
Colt Telecom	Yr to Dec 31	215.1	(81.5)	55.6L	(32.5L)	10L	(7L)	-	-	-	-	-
Eidos	9 mths to Dec 31	189	(103)	32.4♠	(13♥)	112.3	(50.2)	-	-	-	-	-
Estates & General	Yr to Dec 31★	18.3	(17.3)	2.64	(2.25)	8.8	(7.9)	1.1	May 13	0.5	1.6	0.8
First Active‡	Yr to Dec 31	-	(-)	36.6♥	(31.7)	28.5	(-)	1.89	May 17	-	1.89	-
Galliford	6 mths to Dec 31★	107.8	(74.3)	1.1	(0.76)	0.89†	(0.59)	0.5	Mar 12	0.5	-	1.1
Golden Rose	Yr to Sept 30	3.22	(3.02)	1.47L	(0.987)	10.3L	(6.9L)	-	-	-	-	-
Green Property‡	Yr to Dec 31	45.3	(27.5)	21.5	(12.1)	17.34	(15.88)	4	Mar 20	3.5	5.8	5.3
Hanson	Yr to Dec 31@	1,825	(2,478)	198.5♥	(609.3♥)	54.5	(88.1)	8.75	May 7	8	12.75	12
Isotron	6 mths to Dec 31	6.96	(6.5)	2.51	(2.61)	14.1	(14.7)	2.07	Apr 30	2.45	-	4.35
KBC Advanced	Yr to Dec 31	39	(33.1)	8.35	(8.2)	13.13†	(11.31)	2.6	Apr 8	2.8	3.9	2.6
Lasmo	Yr to Dec 31★	536	(722)	363L♠	(154)	44.2L	(3.8)	2.3大	Mar 31	2.3大	2.3大	2.3大
Legal & General	Yr to Dec 31	-	(-)	407♥	(610)	32.13	(39.56)	9.92	May 4	8.7	14.48	12.7
Lex Service	Yr to Dec 31	1,528	(2,002)	100.3♥	(44♠)	80.4	(25.2)	11.7	Apr 28	10.7	19.5	17.5
Lincat	6 mths to Dec 31	12.6	(12.2)	2.73	(2.51)	19.7	(18.2)	4.5	Apr 6	3.8	-	12.5▥
Linx Printing Tech	6 mths to Dec 31	12.6	(11.3)	1.87	(1.48)	7.7	(6.6)	1.9	Apr 19	1.6	-	13.2
London Bridge Soft	Yr to Dec 31	22.4	(11.3)	7.37	(3.7♠)	20.11	(10.03)	3	Apr 30	3	4.5	3
Magnum Power	6 mths to Dec 30	0.352	(0.600)	0.666L	(1.05)	0.73L	(1.4L)	-	-	-	-	-
Mucklow (A&J)	6 mths to Dec 31	-	(-)	7.19	(6.85)	5.71	(5.32)	3.76	Jul 1	3.6	-	7.53
Newmark Tech Φ	6 mths to Oct 31 ©	3.33	(1.02)	0.033	(0.08L)	0.05L†	(0.19)	-	-	-	-	-
Orange	Yr to Dec 31★	1,213	(914)	98.1♥L	(139.1L)	[illegible]	(12L)	-	-	-	-	-
Pifco	6 mths to Oct 31	21.4	(24.2)	1.98	(2.07)	9.3†	(9.9)	3	May 4	3	-	8.09
Preston North End	6 mths to Dec 31	2.3	(2.2)	0.420L	(0.423L)	20.2L	(21L)	-	-	-	-	-
Provident Fin'cial	Yr to Dec 31	506	(444)	145.9	(136.5)	40.12♦	(34.77)	13.8	May 7	11.75	22.5▥	19.5
Quadrant Health	Yr to Dec 31	1.26	(2.01)	5.31L♠	(2.9L)	11.4L†	(11.3L)	-	-	-	-	-
Quayle Munro	6 mths to Dec 31	1.21	(0.295)	1.06	(0.465)	23♦	(8.8)	4.5	Apr 6	4.2	-	12.6
Ricardo	6 mths to Dec 31	45.1	(40.3)	4.5	(3.85)	6.7	(5.4)	2.3	Apr 30	2.2	-	6.6
Ring	6 mths to Dec 31	37.9	(44.2)	1.83	(17.1L♠)	2.4	(44.2L)	0.8	Jul 16	nil	-	1.8
Rio Tinto	Yr to Dec 31	5,562	(5,759)	910	(1,285)	30.4	(53.1)	22.03	Apr 7	21.55大	31.99●	31.92大
Sinclair (Wm)	6 mths to Dec 31	23.8	(24.3)	2.1	(2.83)	6.4	(8.6)	2.4	May 7	2.4	-	9.1
Smith & Nephew	Yr to Dec 31	1,053	(1,048)	134.5♠	(152.4)	8.42	(10.24)	3.8	Jun 4	3.8	6.2	6.2
Sunderland	6 mths to Nov 30	9.85	(8.01)	0.275	(0.518)	3.4	(5.5)	nil	-	1.6	-	4.8
Synter	Yr to Dec 31	294.5	(217.8)	8.1	(7.97)	24.8	(28.4)	5.2	May 27	-	7.8	-
Taraus	Yr to Dec 31‡‡	5.48	(0.56)	2.97L♠	(0.009)	19.6L	(0.11)	-	-	-	-	-
Tottenham Hotspur	6 mths to Jan 31	23.6	(19.6)	4.13	(4.02)	2.7	(2.1)	-	-	0.33	-	0.58
United Assurance	Yr to Dec 31	-	(-)	193.9♠	(226.7♠)	34.2	(40.2)	16.5	May 4	14	24.5	21
Usher (Frank)	6 mths to Nov 30	10.5	(11.6)	0.74♠	(1.01)	7.3♦	(9.4)	4	Apr 1	4	-	11
Waste Recycling	Yr to Dec 31	45.9	(27.2)	10.6	(6.13)	14.7†	(10.9)	2.2	May 7	1.9	3	2.5

Earnings shown basic. Dividends shown net. Figures in brackets are for corresponding period. ♠After exceptional charge. ♥After exceptional credit. †On increased capital. ♦On reduced capital. ★Comparatives restated. ‡Adjusted for share split. ΦAim stock. ‡Irish currency. ▥Excludes special. @Figures pro forma. 大Foreign income dividend. ©Comparatives for 7 mths. ●Contains FID element. ‡‡Comparatives for 8 mths to Dec 31. #Restated.

INSIDE TRACK

INTERVIEW WERNER BALDESSARINI

Dressing up to the nineties

Alice Rawsthorn finds Hugo Boss's chief ready and able for its latest, more feminine challenge

'Fashion has a lot to do with emotion and that's very difficult for outsiders to understand'

Jason Orton

When two men walked into Werner Baldessarini's fashion boutique in Munich and asked if he would sell their company's suits, the answer was no: not least because the suits were made in Germany and his stock was mostly Italian.

Undaunted, his visitors returned a few months later and asked Mr Baldessarini to join their company Hugo Boss as a designer. Eventually he agreed. That was 22 years ago. Last autumn he took charge by becoming chairman and chief executive.

When Mr Baldessarini, now 54, arrived, Boss was a small clothing manufacturer in Metzingen, on the outskirts of Stuttgart. It now owns one of the world's best-known clothing labels in Hugo Boss and the top-selling men's designer fragrance in Hugo.

Yet he has taken the helm at a time when Boss faces what could be its toughest challenge – launching a women's line. "We'd like to launch the women's collection next year but we'll wait till we're ready. It's too important to rush. There's no fixed timetable," Mr Baldessarini says.

Hugo Boss has reinvented itself before, notably in the early 1990s, when the sleek, sharp-shouldered style of power dressing, with which it had been so successful in the 1980s, fell out of fashion. Mr Baldessarini had helped to define that look with Jochen and Uwe Holy, the two men who "discovered" him in his Munich boutique.

Together, they turned Boss into a brand aimed at clothes-conscious yuppies who wanted to be thought to be wearing designer labels but could not afford Giorgio Armani and shied away from the *outré* styles of Yohji Yamamoto and Comme des Garçons.

By exerting rigorous control over a network of subcontractors in lower-cost countries, Boss produced high quality clothes at not-too-inaccessible prices: and a high profile programme of golf, tennis and Formula One sponsorship raised awareness of its brand name.

The Holys lost control of the company in 1989 when, after an ill-starred US acquisition, they sold their majority stake to Leyton House, a Japanese trading company that subsequently sold it to Marzotto, the Italian textile group. The brothers left in 1992 and Marzotto appointed Peter Littmann, a German marketing whizz, as chairman.

Along with Mr Baldessarini he redefined the Boss look by introducing softer, sportier styles to the Hugo Boss collection. They also hired cutting edge photographers, such as Jürgen Teller, to shoot advertising for the younger Hugo range.

The sports sponsorship continued under Mr Littmann, but he also sought to create a more cerebral image for the brand by beginning an ambitious sponsorship scheme with the Guggenheim Museum. This has funded exhibitions and ad hoc projects, notably Jeff Koons' floral *Puppy* sculpture outside the Guggenheim Bilbao. The company also initiated the biannual Hugo Boss art prize.

Mr Littmann left Boss in early 1997 and Joachim Vogt, a former McKinsey consultant who had taken charge of production, became chairman. He departed last autumn and was replaced by Mr Baldessarini, who sees his role as restoring continuity.

"Joachim Vogt was a statistics man from McKinsey, whose world was very different from ours," he recalls. "We wanted to move in the same direction but had different ideas about how to get there. Fashion has a lot to do with emotion and that's very difficult for outsiders to understand."

Mr Baldessarini says his immediate priority is to "make the company less bureaucratic". He has little faith in the colour consultants, trendspotters and style forecasters who advise many fashion groups, preferring to encourage his employees to respond to their instincts.

"Why would we want to work with consultants, who tell everybody the same things each season?" he says. "We do our own research while we're running around the world. If you consider things for too long, they never get done. The Swatch wouldn't have been launched if it had been researched."

He sees no need for another sea change in Boss's styling like the one he and Mr Littmann initiated in the early 1990s. Similarly, he claims to be happy with its advertising, although future campaigns will be less overtly masculine, as soon as a launch date is finalised for the women's collection.

An avid F1 fan, Mr Baldessarini is committed to continuing Boss' sports sponsorship. "It's been very important for us in making the brand well-known worldwide," he affirms. "How else could we have done it from a small town in Germany?"

However, he may seek changes on the arts front. "I'm happy with what we've achieved in our five-year relationship with the Guggenheim," he states. "We haven't decided exactly what we're going to do in future but I'll discuss it with Thomas Krenz [the Guggenheim's director] this month."

Despite the boardroom turbulence, Boss' trading performance has remained robust in recent years. Its exposure to Asia is so slight that, unlike other expensive European brands, it emerged unscathed from the Asian economic downturn to raise turnover from DM1.14bn (£400m) in 1997 to roughly DM1.4bn last year. Mr Baldessarini expects continued growth.

"There's been so much consumption, that people are tired of having too many things. They're choosing more carefully and spending more money when they buy. Hopefully, Boss will benefit from that."

Puppy love: Boss sponsors Jeff Koons' floral dog sculpture outside the Guggenheim Bilbao

KEN WARN
FILE FROM BUENOS AIRES

The anarchists of the tarmac

In a country where wearing a seatbelt is seen as cowardice the Argentines would appear ripe for road safety education

The World Bank may be about to embark on one of its most ambitious missions yet: helping the Argentines to drive safely. A team of its experts is due in Argentina next month to assess the country's suitability as a pilot study in the Global Road Safety Partnership, an international public and private sector initiative.

The experts had better keep their wits about them. Argentines drive with a kind of free-wheeling anarchy that defies regulations and laughs at danger. Many drivers trust to quick reactions and luck to keep them out of trouble.

All too often, their trust is misplaced. Between 6,000 and 7,000 Argentines die on the roads every year, in a country where car ownership is still low by US or European standards.

In 1997 there were 186 road deaths per million Argentines, not as bad as the 222 per million people registered in Venezuela, but three times the rate of the UK or Sweden. The toll was a third greater than in Italy, a country not renowned for safe driving.

A good place for the World Bank team to start would be the Avenida Sante Fe in downtown Buenos Aires, just before it reaches the city's main pedestrian shopping street. Here, the road is painted with the white stripes that normally denote a zebra crossing. But the traffic never stops. Foreign tourists, ambling out of the pedestrian zone towards the leafy Plaza San Martin, wait for a break in the swirling traffic. Puzzled and impatient, some try to take the initiative by stepping on to the crossing. The cars do not even slow down. The tourist is forced to sprint for the kerb amid a blaring of horns.

As they stand marooned by the swarming vehicles, the World Bank team may see some dispiriting sights. Entire families often climb on to a single motorbike, with a mother on the back cradling a tiny baby in her arms. Parents like to hold their children on their laps on front passenger seats, holding the child towards the windscreen.

Wearing seatbelts is widely regarded as cowardice or folly. Taxi-drivers are apt to drape the belts across their chests without fastening them.

Head-on crashes are common. Pedestrians regularly fall victim to vehicles shooting red lights.

Enforcement is lax. Motorists pulled up by the police for traffic offences can often talk their way out of a charge, helped by handing over some cash. Officials admit that the driving test, a model of its kind on paper, is not rigorously applied in some provinces.

Foreigners react in different ways to the terrors of the tarmac. Some refuse to drive at all. Others quickly adapt to local driving habits. "The Argentine way is to just look out for what's ahead. Don't worry about the guy behind – that's his problem," says one senior foreign official.

Partly for self-protection, the diplomatic corps has enthusiastically embraced the growing local preference for giant, gleaming 4x4 vehicles. "It's only in a dirty great big 4x4 that I feel anything like safe," says one diplomat. "I can see what's going on, and other people have to get out of the way."

The expense would otherwise be hard to justify to the taxpayers back home. Four-wheel drive is even more redundant in Buenos Aires than in most other cities: the nearest hills are miles away.

Why is Argentine driving so spectacularly bad? Are drivers unconsciously thumbing their noses at rules laid down by a state that many hold in contempt?

Or are the causes largely cultural? Many drivers appear to put more faith in the supernatural than in the highway code. Taxis are frequently adorned with crucifixes, worry beads or lucky charms, while buses have stickers proclaiming the protection of the Virgin of Lujan, patron saint of the motor transport industry.

The relatively underdeveloped road system is clearly a factor. The worst drivers like to get up to near-motorway speeds in the narrow grid of streets in central Buenos Aires, unimpeded by the dearth of traffic lights. Driving across many junctions is a game of chicken, with drivers reluctant to give way.

Ernesto Tenenbaum, under secretary of road safety, has a more mundane explanation: "The main factor is that driving skills have just not kept up with mass car ownership."

He believes that the incidence of accidents is levelling out, and that Argentina is ripe for an educational effort aimed at drivers and pedestrians alike – hence the approach to the World Bank. "We are not different from other people. It's a question of education, and of having the correct policy and enforcing it."

BUSINESS EDUCATION WOMEN AND LEADERSHIP

The holistic approach

Tracy Corrigan looks at a scheme that aims to prepare women both professionally and psychologically for leadership

It is not a business school, or a diversity programme, or a networking opportunity, though it has some of the same goals. The Woodhull Institute for Ethical Leadership, launched today, is a not-for-profit educational institution designed to prepare young women for leadership.

The institute, housed in a 300-acre site outside New York City, was set by a group of successful women who felt that "many of us, looking back, realise that we spent our 20s not knowing how to get started," says Naomi Wolf, the feminist writer who is president of the institute.

The institute, named after the first woman to run for the US presidency, seeks to provide a "holistic approach", she says, through a blend of practical courses, weekend retreats, mentoring and support designed to provide "all the tools not only for professional preparedness but also for psychological preparedness".

Ms Wolf began raising funds for the project with fellow board director Margot Magowan, a philanthropist and radio producer, a little over a year ago. She came up with the idea because "I travel a lot to speak to different groups of young women and I would encounter very bright, very ambitious, very idealistic young women who were profoundly ill-prepared to take on leadership positions".

Ms Wolf found that as well as lacking skills such as public speaking, many young women also "lacked the psychology of intelligent risk-taking". While young men in their 20s were "trying things... their female peers had a lot of fear about leadership, no matter how smart they were".

Certainly, there is still plenty of room for improvement in women's access to positions of power in the US. Despite diversity programmes and affirmative action, there were two chief executive women officers running Fortune 500 companies in 1987. Ten years later, the number was unchanged.

One reason efforts such as diversity programmes have largely failed to deliver, believes Melissa Bradley, a founding director of the institute, is that "many companies have looked on it as a numbers game".

The institute has found practical ways of reaching a far broader range of women than might aspire to attend Harvard Business School, through links with grass-roots organisations such as Colin Powell's America's Promise, a not-for-profit group to help and to develop young people, as well as diverse educational establishments which include community colleges as well as Ivy League schools.

With an advisory board which includes writer Erica Jong and actress Cybil Shepherd, it also sounds as if it might be more fun than Harvard Business School.

The Woodhull Institute for Ethical Leadership at 61 E 8th Street, Suite 130, New York, New York 10003

Woodhull@aol.com

Wolf: 'We spent our 20s not knowing how to get started' AP

EQUITIES

High-fliers are dragged back to earth

EUROPEAN OVERVIEW

By Vincent Boland

European stock markets succumbed to profit-taking yesterday and ended lower across the board, with recent high-flyers in the telecommunications and pharmaceuticals sectors leading prices lower. A weaker start on Wall Street also aided the retreat in a busy session.

The losses came despite another sharp fall in prices in the US treasury bond market at the European close. Analysts said that investors were beginning to heed comments by Alan Greenspan, the chairman of the US Federal Reserve, who again warned this week about the dizzying levels of US share prices.

Yields on US treasuries have been rising steadily, and the dollar was also weaker. That helped the euro to climb back above $1.10 after its low points earlier in the week.

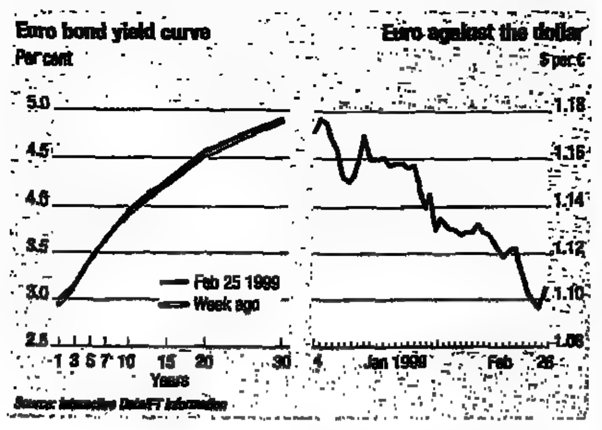
Recording losses of between 1.7 per cent and 2 per cent, the FTSE Eurotop 300 index of leading European stocks fell 20.81 to 1,229.11 while the FTSE Eurotop 100 index closed 56.6 lower at 2,824.47. The FTSE Ebloc index of shares in euro-zone companies fell 18.3 to 1,012.64.

Declines were led by the leading shares. Glaxo Wellcome shed €1.30 to €30.05 after it said its new flu drug had been turned down for approval by the US Food and Drug Administration. Other drug makers tumbled in sympathy – SmithKline Beecham fell 60 cents to €12.93 while Astra, struggling to defend its merger with Zeneca, ended 30 cents lower at €18.24.

DaimlerChrysler fell €4.60 to €87 on profit-taking despite good results, while Volkswagen was €3.40 lower at €59.50 as investors continued to take profits after it warned its 1999 results were unlikely to match those of 1998. The auto sector was among the day's weakest, off 3.4 per cent.

The telecoms sector, ripe for profit-taking after its recent surge, shed 2 per cent. Among the casualties was Olivetti, which fell another 20 cents to €2.74 as it struggled to get back on track with its hostile takeover of Telecom Italia, which ended 30 cents lower at €9.80.

Vodafone fell 50 cents to €16.78, but Telefónica added 28 cents to €42.25 after good results. Banks, also in the reporting season, were mainly lower. Dresdner fell €1.20 to €32.66.



Source: Interactive Data/FT Information

FTSE Actuaries Share Indices — European series

Feb 25

National & Regional Markets	Euro index	Day's %	change points	Yield gross %	xd adj ytd	Total retn (Euro) €
FTSE Eurotop 300	1229.11	-1.66	-20.81	2.17	1.33	1288.99
FTSE Eurotop 100	2824.47	-1.96	-56.60	2.17	4.56	1014.14
FTSE Ebloc 100	1012.64	-1.78	-18.30	1.97	0.60	1028.52
FTSE EuroMid	1188.78	-0.41	-4.95	2.77	1.30	1233.15
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	1222.15
[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	1257.95

OTHER INDICES

[illegible]

CURRENCIES & MONEY

EURO SPOT FORWARD AGAINST THE EURO

[illegible]

BONDS

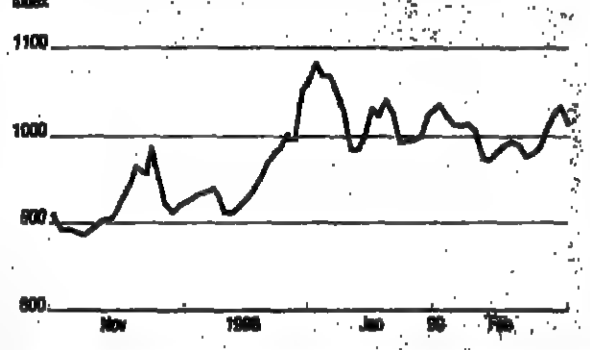
INTEREST RATE SWAPS

Feb 25	Euro-€ Bid	Euro-€ Ask	£ Stlg Bid	£ Stlg Ask	SwFr Bid	SwFr Ask	US $ Bid	US $ Ask	Yen Bid	Yen Ask
1 year	3.11	3.14	5.34	5.37	1.48	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
2 year	[illegible]	[illegible]	5.23	5.26	1.68	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
3 year	3.35	3.39	5.22	5.26	1.93	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
4 year	3.52	3.56	5.21	5.25	2.14	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
5 year	3.68	3.72	5.21	5.25	2.33	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
6 year	3.83	3.87	5.21	5.25	2.50	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
7 year	3.97	4.01	5.22	5.26	2.67	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]

EURO-ZONE BONDS

[illegible]

FTSE Ebloc 100



FTSE EUROTOP 300

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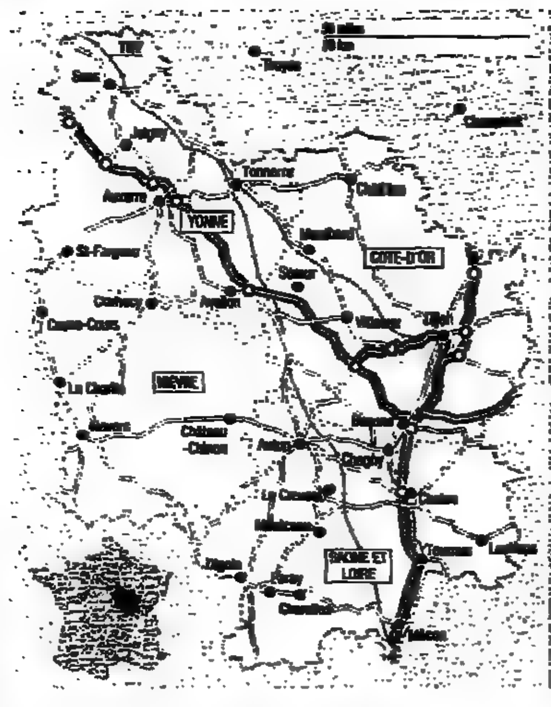
FINANCIAL TIMES SURVEY

BURGUNDY

FRIDAY FEBRUARY 26 1999

Mapping out future growth

Development will be conditioned by the extent to which the region can compete for investment, says Robert Graham



If one were throwing darts at a map of the newly-created euro-zone, Dijon, the capital of Burgundy, would come close to being a generous bull's eye. "Within the radius of a day's drive, you will find 80 per cent of the wealth of the European Union," says Henri Jolimet, director of economic research at Burgundy's regional council.

The council provides a neat little map with travel times fanning out from Dijon in circles, a bit like a dartboard. Ten hours away by road lie Saragossa in Spain, Florence in Italy, Hamburg in Germany and Birmingham in the UK. Brussels, Cologne and Milan are all within six hours of the Burgundian capital. In France itself, Dijon is almost halfway between Paris and Lyon, the two major centres of economic activity in France. Paris is just over an hour-and-a-half by train.

The once-famed wealth and power of the dukes of Burgundy owed much to their control of this strategic position, astride the main north-south land and water routes of eastern France. Today, its future development will be conditioned by the extent to which it can compete for investment by exploiting its location in the nascent euro-zone.

This will not be as easy as its privileged geography suggests. Burgundy finds itself bordered by the two wealthiest regions in France: the Isle-de-France region of Paris and its surrounds, and the Rhône-Alpes centred on Lyon. Both in terms of economic activity and population, Burgundy is in a smaller league. It's 1.6m population is one of the lowest densities in France and accounts for under 3 per cent of the country's GDP. The population in the post-war years has grown well below the national average and the region has seen relatively little immigration. The rural population has shrunk, notably in the wild semi-mountainous Morvan area in central Burgundy. (Mobile phone coverage, the symbol of modernity, is not yet complete here). But the northern part of Burgundy round Sens has become caught up in the Paris region's pole of attraction; and, at the other end, Macon has found the Lyon area a magnet.

This pattern has been accentuated since the early 1980s by the high-speed (TGV) train link between Paris and Lyon, which bypassed Dijon. "For the past 15 years, we have ceased to have so much contact between Dijon and Lyon because of the Paris-Lyon TGV line," says senator Maurice Lombard, chairman of the body running the greater Dijon area. "We also find qualified young people being pulled towards Paris and Lyon and have to fight hard to counter this."

But Burgundians are scarcely hard done-by. Drive through the neatly kept historic towns and villages, often graced by magnificent romanesque churches, and they exude a comfortable prosperity. The long restaurant menus, rich with local delicacies, are a constant reminder that they have got their priorities right.

The economy itself is well balanced between industry, agriculture and services. There has been a largely successful reconversion of the heavy industry and the engineering business round Creusot Loire and Châlon, which threatened employment two decades ago. Indeed, the most dynamic development has taken place round Châlon, which was hard hit by industrial reconversion and has been helped by EU aid funds.

Dominique Perben, the long-time Gaullist mayor of Châlon, believes this is because he had to try harder. "We are very professional and actively seek out investments with three people whose job is to knock on doors lobbying companies to locate with us." Last year, 11 companies pledged new projects creating 600 jobs in the Châlon area.

Investment, both foreign and French, has steadily grown. Despite the relatively small and dispersed workforce, Burgundy was sixth in terms of investment projects in 1998. Between 1996-98 the number of jobs created by foreign investment has jumped from 600 to just under 1,500. Last year, foreign investments worth FFr479m were approved. Significantly, these tended to be more expansion of existing plant than new operations, suggesting the investors' long-term commitment to their Burgundy locations.

Agriculture, driven by the added value of the wine business and the seemingly unstoppable demand for top quality Burgundy reds and whites, continues to be strong; and the impending shake-up of the EU's Common Agricultural Policy should not have a serious negative impact on the region.

The service sector is expanding fastest, especially round Dijon, in activities related to transportation, warehousing and logistics. But tourism still remains an under-developed resource.

Such a balance has enabled Burgundy to take full advantage of the French economic recovery. The jobless rate is 10.5 per cent of the active workforce, a full percentage point better than the national average. However, more than one third of jobs are in the public sector. This limits the role of private enterprise but clearly helps underpin household consumption, especially since the Jospin government conceded a general real pay increase covering 1998-99.

One of Burgundy's weaknesses in promoting development is the relatively small number of even medium-sized businesses with a headquarters in the region. "Over 75 per cent of industrial employment in establishments employing over 20 people depends upon groups which, for the most part, have their headquarters outside the region," notes a recent regional study. This puts a premium on the regional administration understanding business needs and ensuring Burgundy retains its attractions.

Since last April, Burgundy has had a new council headed by Jean-Pierre Soisson, a former minister, mayor of Auxerre and who, briefly, held the job from 1992-93. The 64-year-old Mr Soisson fought the elections heading the list of the centrist UDF. With the left and right equal with 24 councillors each, he opted to rely on the nine votes of the racist National Front to form an administration. A similar alliance in the Rhône-Alpes region provoked an uproar and eventually led to the unseating of the Front-backed government there.

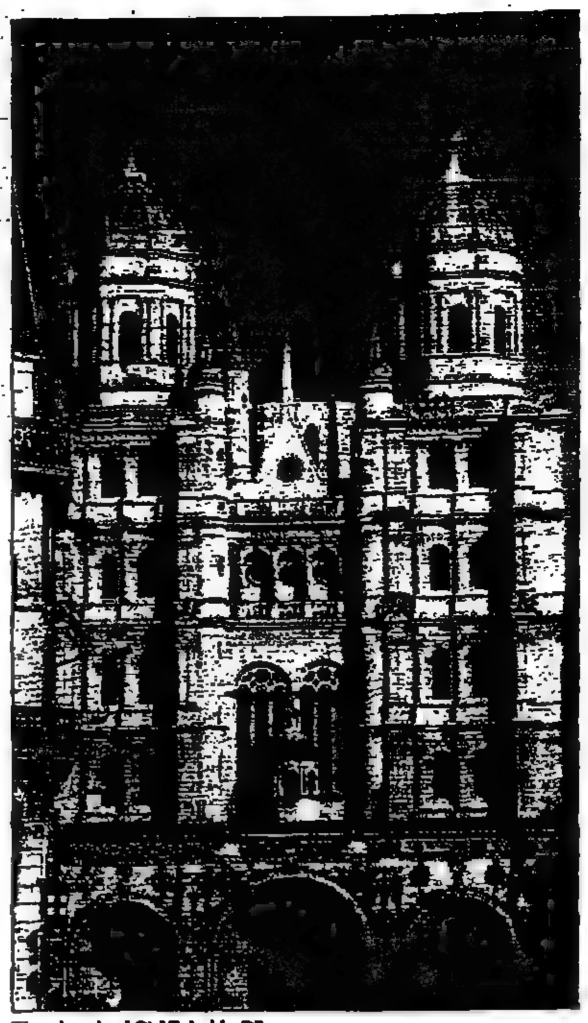
However, Mr Soisson has proved a wilier politician, and the milder criticism of his reliance upon the Front has now evaporated with the recent split in this party. Five councillors have been left backing the line of the Front's long-time leader, Jean-Marie Le Pen, and could eventually be absorbed by the mainstream right; the other four have swung behind Bruno Mégret, who led the breakaway. "I'm a firm believer in decentralisation and will do as much as possible to ensure we focus properly on handling those aspects of development that fall within our competence," says Mr Soisson, who, as a minister, relocated the elite civil service college, ENA, to Strasbourg from Paris.

More than 40 per cent of the 1998 budget went on education and this emphasis, as in most other French regional administrations, will not change. However, he will try to cut back administrative costs (resisting, among other things, the introduction of the 35-hour week) and reduce spending to ease the debt service cost.

New emphasis will be placed on professional training and links between industry/business and the higher education. He has also signalled his desire to reduce the local tax burden by ending the regional stamp duty of FFr225 charged on driving licences.

But the project he wishes to secure during his administration is the construction of a new TGV rail link from Dijon, running east to Mulhouse on the German border that would cut times with the major German cities.

The government is studying the idea but has given priority to a costly new TGV eastern line out of Paris to Strasbourg and no decision is likely before two years. All the local politicians are backing the project. If adopted, Burgundy would become a real nodal point for freight and other operations.



The church of St Michel in Dijon

Cultivated Dijon

Cistercian monks first spread the renown of Dijon in the 11th century and played an important part in refining the cultivation of vines in the surrounding countryside. Now France's ninth biggest city and the capital of the Burgundy region, Dijon remains one of the best preserved large historic centres in France.

The city retains an enviable mix of university life, quality restaurants, monuments and industrial vitality based round its strategic location in Europe's transportation system.

Greater Dijon now accommodates almost 260,000 people. Growth is being shaped round the concept of the Burgundian capital acting as hub for agri-business, biochemistry and food technology, spearheaded by a newly-established Institute of the Senses.

It is also attempting to catch up with other cities such as Montpellier and Strasbourg in the convention business: two major conference centres are now operating and a new 1,600-seat auditorium with the best state-of-the-art acoustics in the country is finishing its trials.

ECONOMY by Robert Graham

Motoring along nicely, on back of national recovery

The region continues to enjoy the benefits from wine-making and agriculture, with a helping hand from the automotive industry

Of all France's regions, Burgundy has managed to retain one of the most well-balanced economies. Activity is spread right through heavy and light industry to a strong agricultural base with high added value plus a services sector which is expanding fast.

By virtue of its geography close to the main European markets, the economy also has an important export vocation. As a result, Burgundy has been able to reap the benefits of France's economic recovery. This took hold in late 1997 on the back of an export boom and has been since sustained by government-stimulated domestic demand. Overall, unemployment is 10.5 per cent, a percentage point below that of France as a whole.

Burgundy's population in agricultural employment continues to be above the national average of 4.8 per cent at just over 7 per cent. This is because large parts of France are covered by flat capital-intense cultivation.

In the case of Burgundy, the percentage devoted to such capital-intense crops as cereals and, latterly, rapeseed, is smaller. But in contrast, the region benefits from the highly successful wine-business and a long-standing tradition of cattle farming (the famous Charolais) which combine to let agriculture generate 6 per cent of the region's output. The latter also contribute to agro-industries and the tourist sector.

A large area is covered by the wild semi-mountainous Morvan and one third of Burgundy is wooded. The big chunk of the Morvan right in the centre of the region is the least populous part, helping to explain why Burgundy has a population density of almost half the national average. Burgundy's population averages 51 per kilometre but in 48 central cantons the density falls as low as 20.

The most populous parts follow the road-rail communications, and are usually close to the three principal river systems: the Loire, Saône and Yonne. The Dijon-Macon corridor is the most economically dynamic, followed by the Yonne valley from Auxerre to Sens, along with the upper reaches of the Loire round industrial Nevers. With the draw of the Paris region at one end and the Lyon area at the other, Burgundy's overall population has grown only 1 per cent from 1982-90, four times below the national level.

A new census being taken this year is expected to confirm this tendency. The main exception will continue to be the Côte d'Or along the Beaune-Dijon axis, which benefits from the central transport connections linking Burgundy to the rest of France.

The census is also expected to highlight how the under 30s tend to be attracted to the big cities, especially Paris and Lyon, while Burgundy draws people back later in their working life and certainly for retirement. Already at the last census in 1990, the proportion in Burgundy of retirement age was over 17 per cent compared to the national average of under 15 per cent.

Industry accounts for almost a quarter of the workforce. This has remained fairly constant over the past two decades even though the heavy industry centred round Creusot Loire has seen major upheavals. Despite the difficulties experienced by steel and heavy engineering in Creusot Loire, the area has avoided becoming a 'rust belt' and has successfully reconverted. It retains some of the big employers, notably Alstom (casting and welding for train coaches) as well as a special steels capacity.

Overall, Burgundy's industry survived the recession of the early 1990s in reasonable shape. The automotive sector, in particular, has grown in strength with the region profiting from the presence of plants of Michelin, Peugeot, Iveco and a host of suppliers led by Valeo.

About 180 companies are linked directly to the automotive sector, employing more than 15,000, in such activities as exhaust pipes, dashboards, security belts and anti-theft devices. A further 700 companies are estimated to be working as sub-contractors. Hand-in-hand with this sector, Burgundy also houses a growing plastics and pharmaceuticals industry.

The bulk of employment, however, continues to be generated in the services. Burgundy has 63 per cent of the workforce in services, slightly below the national average. While the numbers involved in commerce have declined in the past decade, those in hotels and restaurants has grown almost 30 per cent to more than 15,000.

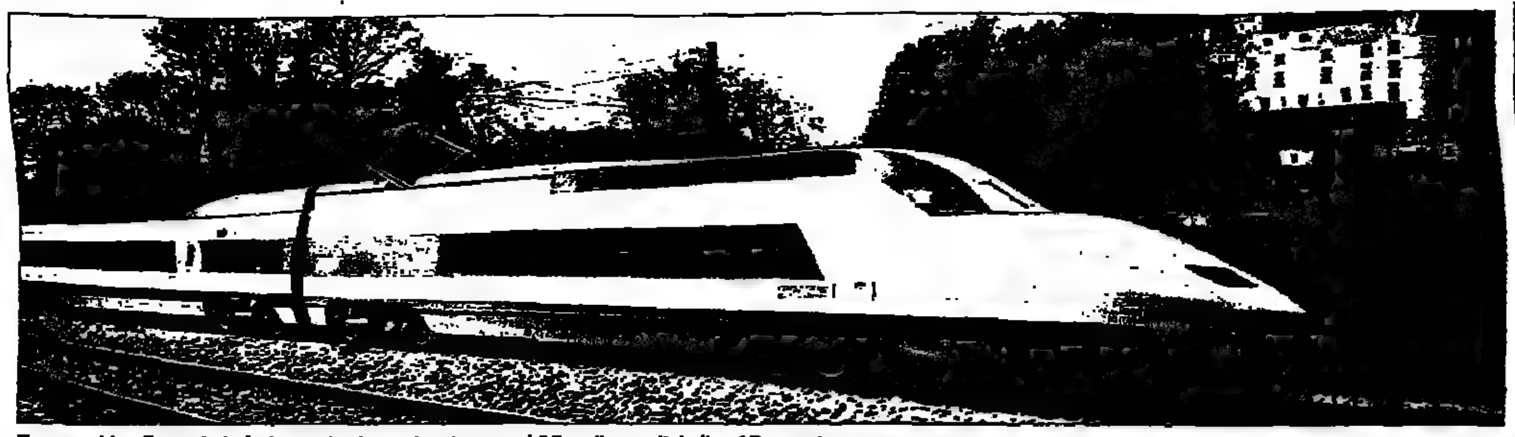
In terms of the local economy, a more important phenomenon has been the sustained rise in public sector employment, especially in health and social services. Between 1989-94, the last available figures, the number jumped 5,300 to 27,400.

Overall, the public sector accounts for more than a third of all jobs in Burgundy. Between the central civil service, local administrations, a big military presence, the health service, teachers, employees of the railways (SNCF), the post office (La Poste), the state electricity concern, EdF, and France Telecom (still majority state-controlled), there are almost 170,000 persons.

Given that public sector salaries have been increased well above inflation in 1998 and again for this year, the presence of this large number of "safe" jobs provides a significant underpinning to the region's household consumption. Furthermore, in the more remote areas, the villages and small towns are almost entirely sustained by state salaries and pensions.

Politicians of all colours back this big public sector. But with La Poste, EdF and the SNCF beginning to face outside competition in France, some of these jobs must be seen to be at risk. At the same time, the national defence budget is under threat. This means that, in the future, the private sector will be called upon to generate more jobs.

These could come partly through tourism, further development of agri-business and increased investment in transportation.



Express rider: France's train à grande vitesse has bypassed Dijon, the capital city of Burgundy

INFRASTRUCTURE by Robert Graham

Link up to TGV, très vite!

The Côte d'Or wants the full benefits of France's high-speed railway system

Any conversation about the development of Burgundy quickly touches on rail links and the extension of the TGV (train à grande vitesse) high-speed line east from Dijon to Mulhouse on the Alsatian border with Germany.

This new line is seen as the central element in a new series of infrastructure projects that will ensure the region capitalises on its geography in the next century.

Fast trains will accelerate dramatically the north-south and east-west communications in Europe and set a new pattern of freight movement and passenger behaviour that will, in turn, determine corporate locations.

Burgundians have already seen the impact of the Paris-Lyon TGV line, which started full operation in 1981. It brought the core of the Rhône-Alpes region within two hours of Paris but bypassed Dijon, the capital of Burgundy. Though the route passed through Burgundy – there is a small TGV fork linking the conventional Paris-Dijon rail line – the region has not been a major beneficiary of France's high-speed rail system.

Instead, Burgundy has benefited from its nodal position in France's major road network, enabling it to become a logistical and warehousing centre for many national and foreign businesses.

But without some movement off the roads and into rail-freight and more imaginative use made of multimodal transport (road-rail-water), Burgundy's already heavily used trunk road system will become saturated in the early years of the next century.

The A6 is the country's most heavily used highway, running from Paris to the south, and is at its most crowded on the Beaune-Macon stretch, where traffic filters to and from the north and east.

Burgundy is the transit route for 75 per cent of all road traffic between Spain and Germany; it acts as the main truck line between the industrial regions of northern Italy and northern Europe; it also channels half the road freight between the UK and Spain and acts as an important funnel for goods to and from Switzerland. Roughly six times more freight is carried by road through Burgundy than by rail.

Despite the logic of switching to rail and speeding up travel times within France and across Europe, any decision on new investments will be influenced by politics.

The Jospin government decided earlier this year to give the go-ahead to a new FFr20.5bn (€3.12bn) TGV line running from Paris to Strasbourg. Due to halve travel times to just over two hours, the 320-km line will be completed by 2006.

The decision was not based on financial logic but a statement of France's will to ensure the seat of the European parliament in Strasbourg be properly connected to the French capital and locked into better links with German cities such as Frankfurt.

The agreement on the Paris-Strasbourg project involved central government, regional administrations and EU funding. The central government agreed to provide FFr8bn, and no new major national rail project is likely to find funding before 2001, if then. However, the backers of the 190-km Dijon-Mulhouse link believe it could be up and running by 2005.

The region fully backs the project, tentatively estimated at FFr12bn. The aim is to ensure it is accompanied by a TGV branch from Besancon down to Bourg-en-Bresse and on to Lyon, giving a much quicker interconnection between Switzerland, Germany and France.

It would also speed up traffic all the way through to Marseilles and Montpellier in the south, with the prospect of an eventual TGV link-up with Spain.

As its proponents argue, this would provide the missing link in a network connecting Frankfurt and the Benelux countries with the Mediterranean and Catalonia. Frankfurt would be five hours from Marseilles.

In freeing up existing passenger routes, they maintain the railways would be better able to carry freight and think more of combining transportation with the 1,000 km of navigable waterways in Burgundy.

Local politicians are relying on the project to be championed in the Jospin government by Jean-Pierre Chevènement, the interior minister, whose political fiefdom is Belfort, through which the Dijon-Mulhouse TGV line must pass.

But they also hope the government will give priority to the scheme after premier Lionel Jospin cancelled plans in 1997 to construct a 220-km canal connecting the rivers Rhine and Rhône via the Saône and the Great Canal of Alsace.

Not only was the project extremely costly at about FFr25bn, it was considered harmful to the environment with large tracts of natural landscape being altered. Burgundian politicians maintain at least some of the government funds earmarked for this scheme should be now diverted to the TGV.

Even if the proposed new TGV network takes longer to materialise, the regional authorities will press ahead with developing more road-rail freight centred on Beaune, Chalon-sur Saône, Dijon and Macon.

PROFILE
GUY ROUX

Paying penalty of football fame

Roux: 38 years as coach of Auxerre football club AP

A poster on the way to Auxerre's Abbé Deschamps football stadium features Zinedine Zidane, hero of France's World Cup victory. "I love making you win," says the slogan. It would make a good motto for Guy Roux.

In 38 years at the helm, the man who is almost certainly the longest-serving coach of a single first-class European football club has taken Association de la Jeunesse Auxerroise – better-known as AJ Auxerre – from the equivalent of the French fifth division to the European Champions' League.

In the process, helped by his frequent TV appearances, Mr Roux, 60, has become a national figure. If there were a poll to determine the most famous Bourguignon in contemporary France, there is a good chance he would win. Not bad for a stocky, self-professed "paysan", or "man of the earth", from Colmar in eastern France, whose entry in Who's Who reveals that he collects postage stamps.

Interviewed in his modest office, behind a cluttered desk, Roux intimates that there are times when he finds his celebrity status "too much". He says: "Being well known is going to a restaurant and not being able to eat because you are signing autographs all the time."

But there are some moments he evidently still gets a kick out of. "I am very popular with children. I am a sort of Tintin or Astérix. A cartoon figure, not a man. They call me 'Guyroux' in a single word. So, I am in my car in Paris, in a quartier where I don't know anyone and a class of 30 seven-years-olds walks by. One sees me – 'It's Guyroux' – and they surround the car. I wind down the window. They want me to sign. There is a mile-long tailback. Honk, honk, honk, honk."

A delightful, entertainingly blunt raconteur – in spite of the previous night's home defeat by Toulouse – he attributes his unprecedented longevity (in footballing terms) partly to the presence of the same club chairman for all but two of his 38 years. "What gets coaches sacked is the league table," he says.

Impressive as the changes have been at Auxerre over the years, a club near Chablis country in a not obviously football-mad town of about 40,000, would probably have found it impossible to climb as high as it has up football's greasy pole were it not for the lack of really big French clubs of the stature of Manchester United, Barcelona or Juventus.

Mr Roux attributes this state of affairs in part to high taxes and social charges. "France is at a disadvantage on a fiscal level," he says. "(There is) a lot of tax and a lot of social charges compared with all our neighbours, compared with Italy, Spain, England and Germany. And so all the good players leave.

"In France, we also have less television money and alcohol-related advertising is forbidden." He does not exactly say he would like French clubs to be able to list on the stock market, but he believes it is inevitable.

French players – and recently French coaches – have enjoyed more success. In the case of the latter, he ascribes this to the high level of training they now receive. "I think French coaches are trained in a more scientific way than, for example, English managers."

He speaks of one of his former players, now playing in England, who told him that, in terms of preparation and diet, England was "a century behind". Later, Mr Roux talks briefly of his own little-known career in English football. "In 1960, I was player number 29 for Crystal Palace for one month in July. I was very well received, but they were in the third division."

For all his rugged exterior, he wants nothing for astuteness, as indicated by his telling of the story of how Andrzej Szarmach, the Polish World Cup striker, came to play for then newly-promoted Auxerre as early as 1980.

"That was an extraordinary adventure because they were Communists. The French sports minister was the mayor of Auxerre, monsieur Soisson, and the Polish sports minister wanted to be on the International Olympic Committee. He needed the Francophone votes. Soisson gave him the Francophone votes. Afterwards, I went to see him and said you must give me a signature for the players. And he gave me the signature. They were extraordinary circumstances."

Other well-known players have passed through the club, including Eric Cantona, the brilliant but volatile former Manchester United playmaker.

Mr Roux's zest for the game is evident in all he says and does as well as the extraordinary collection of artefacts and bric à brac that surrounds him: ancient boots, a terracotta bust, a handsome, well-mounted clock given to him by the father of a player from Côte d'Ivoire.

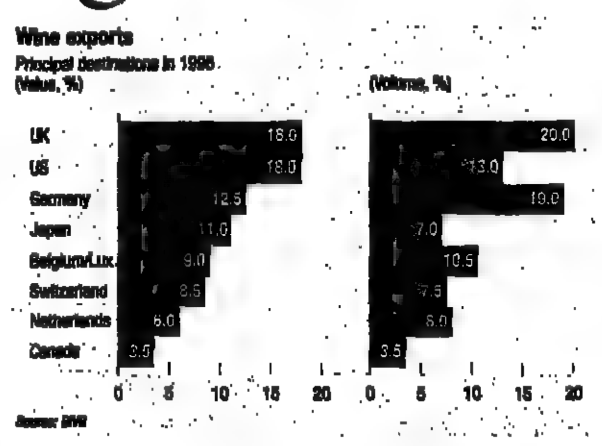
But one day, as he acknowledges, it will be time to give up. "I will continue for as long as I can physically and as long as I want to," he says.

David Owen

WINE by Robert Graham

A case for more vineyards as the demand grows

Exports are worth FFr4bn a year and account for 10 per cent of total French market. They rose 21 per cent in 1997-98



Seeing the vineyards of the Côte d'Or covered in thick snow and ice earlier this month, it is hard to imagine they have produced with regularity over many centuries some of the finest wines in the world.

Burgundy's climate can be harsh and making wine here is a highly skilled operation. There is never the predictability enjoyed by the harvest of the grapes in the New World. But the commitment of generations of growers to quality sustains the high reputation of Burgundy red and white wines.

"We stand out like a tailor-made suit in a ready-to-wear market," says Christophe Denoël, who is in charge of research and marketing at the Bureau Interprofessionel des Vins de Bourgogne (Bivd), the body which supervises the industry.

The area under cultivation is no more than 25,000 ha with an average annual production in the past decade of 1.3m hectolitres. This amounts to only 2.5 per cent of total French wine production, although Burgundy represents 5 per cent in volume of exports. Between 50-60 per cent of production in any one year is exported, a far higher percentage than other regions.

At the same time, because Burgundy's wines are essentially aimed at the top end of the market, its exports are worth almost FFr4bn and account for 10 per cent of total French wine exports.

In 1997-98, the most recent year, exports were up 8 per cent in volume and 21 per cent in value. However, there were wide variations in price rises pending upon the 'appellation'. For instance, Chablis white wines produced from chardonnay grapes grown in the north, near Auxerre, and well separated from the main wine growing area, saw prices rise the least (seven per cent).

Chablis is the 'appellation' which faces the greatest international competition from New World wines, many of which have set out to immitate Chablis (including the name). "In general, Burgundy producers have more demand than they can meet," says Mr Denoël. "Our domestic market is basically the local region and Paris; the rest is for export," he adds.

The strong demand from overseas clients has been responsible for upwards pressure on prices. However, the Bivd, which represents both producers and wine merchants, is acutely aware that prices have to be closely monitored to avoid uneven movements.

One of the interesting features of the traditional family nature of the business in Burgundy is the way in which a sizeable portion of production is sold directly by the growers themselves. In average years, this is around 25 per cent of production. The wine merchants, for their part, a few of whom have also bought up vineyards, account for 65 per cent of sales. The rest is sold by co-operatives.

The UK is the largest market, accounting for 13 per cent in volume, with sales benefiting the past three years from Britain's buoyant economy and strong pound. In 1997-98, sales to the UK were up 21 per cent in volume terms with red wine increasing a remarkable 45 per cent.

The US economy has also seen strong demand for the pricier labels even if volume has remained below 8 per cent of total sales. Japan, another important market (and representing 8 per cent of the export volume), has held up despite its stagnant economy. Sales to Japan have quadrupled in the past decade. The emerging markets crisis has had no noticeable impact.

Shifting tastes have had an important effect on the balance in production between red and white wines. Burgundy reds remain as popular as ever in France but the export market is increasingly favouring whites. Whereas only 42 per of the harvest in 1975 was taken up by whites, the proportion has now grown to 58 per cent.

The emphasis on the top end of the market is in good measure a function of property ownership and the small area under production. There are 4,300 separate vineyards covering 96 different 'appellations'. The average holding is not much more than 6 ha. This eliminates economies of scale and puts the emphasis on skillfull cultivation and production, usually on a family basis.

Of the 10,000 people directly living off the business, at least 5,400 are reckoned to be owners and their families.

Properties are also kept within the families and it is rare to find a property going to any outsider other than a wine merchant. The Bordeaux region, for instance, has seen a rash of prestige investments by wealthy Frenchmen and foreigners. Also, the fragmentation of ownership means a large number of producers share the same 'appellation' – it can be as many as 80. This encourages competition for quality and individuality.

With demand so strong, there is pressure within the Bidv to raise the amount of land under vine. As much as 5,000 ha could be brought under cultivation, equivalent to increasing the current area by almost a third.

At present, the EU in Brussels is reluctant to endorse across the board increases in the area under vine in any country, other than on a very gradual and limited basis. This hurdle of EU wine production ceilings must first be overcome.

However, the Bivd must agree among its members on whether to expand. Those favouring the expansion argue there should be more demand-led growth. The industry is also aware that inheritance practices are changing: to prevent small holdings being split between several heirs, a system of de facto primogeniture is taking root.

As a result, a number of people who, in the past, would have expected to run their own vineyards, are without properties.

Against this, there is a strong argument that extending the area under vine increases the risk of diluting quality. It also risks pushing the long-term price down.

TOURISM by David Owen

The attractions of a delightful landscape

Although British and German tourists are the most frequent visitors to the region, there was an increase of 20 per cent in the number of Japanese tourists last year

In the small, rather downcast-looking town of Saint-Sauveur-en-Puisaye lies one of Burgundy's most intriguing tourist attractions.

Housed in a yellow-walled château beside a massive, ancient, brooding tower, the Musée Colette pays haunting tribute to one of Burgundy's most celebrated daughters: the writer, Sidonie-Gabrielle Colette, who was born in Saint-Sauveur 126 years ago.

If the museum's exhibits – ranging from photographs and mounted butterflies to recreated rooms – are not extensive enough to be wholly satisfying, they nonetheless shed much light on the life of this extraordinary woman.

The delight of the place is in the detail: an address book, open at 'D', lists a Perpignan address for Raoul Dufy, presumably the painter. Many other Bourguignons have left their mark on history, including Gustave Eiffel, Jean-Philippe Rameau and Pierre Larousse (he of the dictionaries). Louis Chevrolet (of the US car company) nearly qualifies, too.

Born in Switzerland, he lived in Beaune from the age of four to 23 before a chance encounter precipitated his emigration. It is strange to think that, had things turned out differently, the first Chevvy might have been built in this handsome Burgundy wine town.

Canon Kir, who bequeathed his name to the popular aperitif, is perhaps a more typical local celebrity: a high proportion of the region's best-known attractions are associated, after all, with either religion or wine.

Sidonie-Gabrielle Colette, the French writer, was born in Burgundy – Mary Evans Picture Library

Indeed, no fewer than seven of the region's 10 most popular cultural tourist sites have religious connotations. Most visited of all, with an estimated 800,000 visitors a year each, are the basilicas of Vézelay and Paray-le-Monial.

The sublime abbeys of Fontenay and Cluny are also on Bourguignon soil. There must be something in the region's rolling hills and well-watered greenery that attracts the spiritual side of human nature.

With other attractions including a large fleet of canal and river boats and a richly deserved reputation for good living, it is surprising that Burgundy is no better than eighth out of 21 French regions for visits by foreign tourists and 11th for their French counterparts.

Nonetheless, with more than FFr9bn a year spent by tourists and an annual peak of more than 20,000 salaried jobs wholly or partly linked to the tourist business, the sector makes an important contribution to the local economy.

By way of comparison, based on figures supplied by Burgundy Development, this is estimated to be about half the annual turnover of the region's food and agriculture industry and twice that of the celebrated wine sector.

Chevrolet Corvette: the car that still carries Louis Chevrolet's name. He lived in Beaune for nearly 20 years

Germans and combined British and Irish are the most frequent visitors to the region's hotels among foreign nationalities, with more than 200,000 of each arriving in the course of last year.

The regional tourism committee is hoping to see an improvement in transport links with the UK, such that six or seven fast trains a day will, in time, link London to Dijon in around five hours. It says there is only one such train a day at present. Another feature of last year was a near 20 per cent increase to more than 20,000 in the number of Japanese visitors to Burgundy hotels.

Overall, however, 1998 saw a more than 2 per cent decline to just over 3m in visitors to the region's hotels. With one of the steepest falls coming in June, it is no surprise that the tourism committee attributes this partly to the impact of the football World Cup, which was held in France.

Burgundy, however, staged no matches and, according to the committee, hosted none of the 32 teams.

Another characteristic of the region's tourist trade is the relatively short length of average hotel stays. This is said to be because many visitors use Burgundy as a pleasant and peaceful stopping-off point to break long journeys to the Mediterranean and elsewhere.

PROMOTION

Image business in focus

Burgundy continues to make headway with its image-making credentials

As the place where photography was invented by Nicéphore Niépce more than 170 years ago, Burgundy has impeccable image-making credentials.

So it is fitting that, with the wealth of new opportunities opened up by the advent of digital technology, the sector has emerged in recent years as a potentially powerful motor for regional economic development.

According to Dijon Promotion, the development agency for the Dijon area, about 70 companies engaged in some aspect of the image business have been identified, more than half of them in the Dijon region.

These companies range from the venerable 160-year-old Nachet microscope-manufacturing concern, to Acti-System, a small but increasingly well-known Dijon operation, which was founded seven years ago; the latter company specialises in the use of optoelectronic methods to measure motion in three dimensions.

Edgard Dauger, Dijon Promotion's director, says that between 200 and 300 jobs have been created in the region in recent years in small and medium-sized companies engaged in one aspect or another of the image business.

"We are really at the starting point of a complete sector of activities," he says. "We are reaching a level of critical mass that is interesting for developing synergies."

In encouraging the development of this high-tech sector in a part of France more traditionally associated with fine wines and food products, the region is drawing on the high level of expertise developed in local educational and research establishments.

"The university understood that image-making was going to be important," says Eric Verrechia, chairman of the image-making 'pole' at Burgundy university.

"In the next five years, progress is going to be dazzling. I think quite simply that we are entering a new era, going from documents printed on paper to documents that are digital but above all dynamic," says Mr Verrechia.

Part of Dijon Promotion's role has been to encourage the main actors to work together and to help companies and researchers to identify what are likely to be the most fruitful market applications, whether in the medical, industrial or entertainment sectors.

"We try to make sure the mix is right," says Mr Dauger.

David Owen

PROFILE
PLASTO

Old family business sticks to sales expansion target

When a Dijon-based chemist named Fournier applied a few drops of glue on a small strip of cloth to make the first sticking plaster in the early 1930s, little did he know that he had just entered a new sector – industrial adhesives – that the family business would soon dominate.

Almost 70 years after the invention of sticking plaster, the family-run pharmacy has grown into the Fournier pharmaceutical group, which employs more than 3,500 people and had sales of FFr3.2bn in 1996.

The sticking tape activity, now a fully-owned subsidiary called Plasto, has become France's biggest – and Europe's second biggest – producer of industrial adhesives, with more than 600 employees and sales of FFr572m last year.

Plasto, still controlled by the Fournier group, was set up as a separate business in 1952, with the French army as one of its main customers, purchasing Plasto tape to seal ammunition crates.

Although the company's growth has relied on innovation and diversification, its four main activities (healthcare, car components, DIY and construction, and industry) still revolve around one core product: adhesives.

Philippe Winter, general manager, says future growth will continue to rely on innovation. Plasto spends the equivalent of 6 per cent of its turnover on research and development, and aims constantly to achieve 30 per cent of its sales with products that are less than three years old.

International diversification is another favoured avenue for growth.

Although its location in Chenove, a suburb of Dijon, is fortuitous – the Fournier group has been there since it was founded in the early 1880s – Plasto has clearly benefited from being "in the centre of Europe".

Within easy reach of the Italian, German and Swiss borders, Dijon is also barely two hours away from Paris by train and just a short drive away from Lyons.

Other groups involved with the car industry also have plants nearby. They include TRW, the US company, and Valéo, France's largest car components manufacturer. PSA-Peugeot-Citroën, one of the two biggest French automobile groups, also has a factory in the region.

One shortcoming of Dijon's location is the scarcity of intercontinental connections. For Plasto, the problem became particularly relevant with last year's opening of the company's US plant, its first in a country outside the European Union. Plasto was ready for the launch of the European single currency earlier this year.

Like many other French companies, it is expected to benefit from the euro, which should facilitate sales in the euro-zone, now that currency risk has been totally removed.

"The euro brings with it both risks and opportunities," says Mr Winter. "We chose to focus on the opportunities."

However, the creation of a borderless market for its products will force Plasto to increase its marketing and sales efforts in an environment that is bound to become more competitive. Productivity gains will also be necessary.

With its largest customers – retailers and car manufacturers – constantly applying pressure to keep margins tight, Plasto will also have to explore markets outside France and the EU.

Last year, for example, Plasto's turnover rose only 5-6 per cent, although sales had grown "somewhat more than that in volume terms".

Mr Winter says: "Car manufacturers [which account for about 45 per cent of Plasto's sales] demand price cuts every year." Plasto already operates a production site in the US, with a local partner. Plans to build plants in Latin America were put on hold last year, in the wake of the emerging markets crisis, notably financial turmoil in Brazil. The project for a Brazilian site should be revived before the end of this year, followed by another, in Argentina.

Plasto's general manager says it spends the equivalent of 6 per cent of its turnover on research and development

"We accompany our large customers overseas," says Mr Winter. "Also, all our production sites are operated with a local partner. We choose partners that are similar to us in terms of size."

Mr Winter says the company will meet its target, set in 1996, of doubling the proportion of international sales to 40 per cent of turnover by 2000. Last year, overseas sales accounted for roughly 35 per cent of total activity.

Samer Iskandar

Liffe members agree to revamp

By Edward Luce, Capital Markets Editor

Members of the London International Financial Futures and Options Exchange last night voted unanimously to simplify the exchange's share structure in a move described as the first step towards its "public flotation".

Under the vote, Liffe will permit a majority of shares in the exchange to be traded by non-members.

The exchange's complex six-tiered share structure will be converted into one class of ordinary shares and trading permits will be separated from share ownership.

The move, which will take full effect before June 1, in effect ends Liffe's member-owned governance structure.

General clearing members of Liffe are required to retain a certain number of shares amounting to about 36 per cent of overall capitalisation.

"If you are becoming a business, profit-centred organisation you must include public flotation as the eventual target," said Brian Williamson, chairman of Liffe. However, officials say flotation is unlikely to take place within the next two years.

The value of shares in Liffe have plummeted over the past 16 months under assault from Eurex, the Frankfurt-based exchange.

However Liffe's market capitalisation has risen from a low point of below £40m late last year to almost £50m this week. Its gradual recovery has been helped by the exchange's success in winning majority market share in the vital contract on Euribor, the three-month interest rate future for the euro.

Europe hit by sell-off in Treasuries

BENCHMARK BONDS

By John Labate in New York and Florian Gimbel in London

US Treasury prices plunged early yesterday, with the yield on the 30-year Treasury trading at levels not seen since last August.

By midday the long bond price had plunged 1½ to 94¾, sending the yield higher to 5.614 per cent.

Among shorter term issues the 10-year note was off 1⅝ to 95⅜, yielding 5.298 per cent.

Analysts saw yesterday's sell-off as further evidence that the market was pricing in an interest rate rise by the Federal Reserve in the face of continued strong reports on the US economy.

In economic reports, durable goods in January rose 3.9 per cent, well above consensus estimates, but unemployment claims came in below expectations.

Two reports due to be published next week are seen as crucial to the Fed's decisions on interest rates in the near term. On Monday, the National Association of Purchasing Management will release its index of business activity, followed next Friday by the employment report.

European government bonds fell victim to the sharp sell-off in US Treasuries, as markets succumbed to growing fears of an imminent US interest rate rise.

UK gilts were particularly hard hit, as domestic factors added to the negative external forces.

"The entire UK yield curve has been affected by today's sell-off. There was no place to hide," said Andrew Roberts at Merrill Lynch.

He emphasised the traditionally high correlation between the US and the UK bond markets. "Even though we have seen a decoupling over the past six months, the present correlation (53 per cent) is still high enough to drag the UK market down," he said.

A survey by the Confederation of British Industry, showing signs of improvement in manufacturers' order books, exacerbated the bearish sentiment in the market.

But Graham McDevitt, at Paribas, was convinced that the roots of yesterday's sell-off ran much deeper.

"Gilts have already been under pressure for a couple of days, as markets have concluded that the Bank of England will leave interest rates on hold. Investors have been overweight in gilts, which is now resulting in a massive unwinding of long positions," he said.

The 10-year gilt future closed 1.15 lower at 116.52, down from 117.67 previously. German bunds were also haunted by fears of higher US interest rates, in spite of positive domestic news.

"There has been some fundamentally good news today, such as the consumer price index figure [0.2 per cent year-on-year]. But that was not enough to protect the bund," said Gerlof de Vrij, at ABN Amro.

But analysts agreed that the bund was continuing to outperform its US counterpart.

"The 10-year bund/Treasury spread has widened to 141 basis points today, up from only 38 basis points on October 1 last year," said Iffy Islam, at Deutsche Morgan Grenfell.

Germany's benchmark 10-year bund future ended 1.28 lower at 114.54, down from 115.82 previously.

Japanese government bond prices were down yesterday, largely due to option-related activity. The yield of the benchmark 203rd 10-year JGB jumped to 1.920 per cent, from 1.880 per cent previously.

"Compared with the last two months of high volatility, we have seen a relatively calm session today," said Mr McDevitt at Paribas.

"The authorities are very keen to stabilise the market ahead of the fiscal year-end," he added.

FHLB back for a second bite

NEW ISSUES

By Khozem Merchant

Federal Home Loan Banks moved quickly to exploit strong demand for short-dated with its second bumper issue of the week. It launched a $4bn bond maturing in two years, days after offering a three-year, $3bn deal.

Charles Berman at Salomon Smith Barney, which lead-managed both FHLB issues, said short-term assets were benefiting from the general uncertainty in the market following comments on the US economy by Alan Greenspan, US Federal Reserve chairman. "There is lots of supply at the short end, but the markets are gripped by uncertainty," Mr Berman said.

Israel Electric, the state monopoly which the government is trying to privatise, offered a 10-year, $500m bond. Bankers said the issue was increased by $100m after demand from more than 50 accounts.

The bond, which was priced to yield 248 basis points over the relevant US Treasury, comes amid a $2bn-$3bn modernisation programme at the utility. Unions have resisted the sale, fearing job cuts.

Scottish & Southern Energy, the recently merged utility, issued a long-dated £250m bond. Bankers said the size of the deal could have been increased, given investors' strong appetite for stock at the time of the merger, but the borrower resisted the temptation. The bond was priced to yield 130 basis points over UK gilts and traded in line.

● The Philippines' debut issue in euros – the first by an Asian sovereign borrower – is likely to be a €300m deal, smaller than had been expected, as the country has already met most of its external funding requirements for this year.

The maturity is likely to be seven years and the offering will probably be priced at a spread of about 385 basis points over US Treasuries, similar to existing 10-year paper.

New international bond issues

Borrower	Amount m.	Coupon %	Price	Maturity	Fees %	Spread bp	Book-runner
US DOLLARS							
Federal Home Loan Banks♦	4bn	5.375#	99.936R	Mar 2001	0.05R	+25(6%-Feb01)	Salomon Smith Barney
HCF (1) Ltd(a)‡	575.2						Merrill Lynch International
Israel Electric Corp	500	7.75#	99.897R	Mar 2009	0.65R	+248(5½%-09)	Salomon Smith Barney
FCC National Bank(b)‡	200	(b1)	99.82R	Mar 2004	0.175R		Merrill Lynch International
Abbey National plc(c)	150	7.10(c)	100.00	undated	2.00		Goldman Sachs Intl
LB Baden-Wuerttemberg(d)	100	(d1)	99.60R	Mar 2009	0.25R		Barclays Capital
Dresdner Bank	75	4.50	98.11	Mar 2001	0.15	+40(5%-Feb01)	Dresdner KB
EUROS							
Crédit Local de France‡	1bn	(f)	100.00R	Mar 2001	0.08R		CAI/CCF Charterhouse
Colt Telecom plc(g)§	440	2.00	100.00	Mar 2009	2.50		Morgan Stanley DW
CAM Global Finance‡	250	(g)	99.847R	Mar 2004	0.15R		ABN Amro
UBS AG(h)	150	2.80	99.50	Jan 2006	0.30		Warburg Dillon Read
STERLING							
Scottish & Southern Energy	250	5.875#	99.083R	Sep 2022	0.625R	+130(8-2021)	Merrill/Warburg DR
SWISS FRANCS							
Ned Waterschapsbank	200	2.50	101.15	Mar 2007	2.625		Paribas
CANADIAN DOLLARS							
GE Capital Canada	100	5.375	99.929R	Mar 2004	0.25R	+21(5%-Sep03)	TD Securities
SOUTH AFRICAN RAND							
African Development Bank	300	14.50	100.00	Mar 2000	0.125R		TD Securities

Final terms, non-callable unless stated. Yield spread (over relevant government bond) at launch supplied by lead manager. ‡Unlisted. §Convertible. ‡ Floating-rate note. #Semi-annual coupon. R: fixed re-offer price; fees shown at re-offer level. a) Harbour City Funding. 4-tranche deal backed by HK commercial mortgages originated by Wharf (Holdings). b) Callable from 11/3/02 at par. b1) 3-mth Libor +10bp. c) Callable from Mar 04 at par. d) Callable on 16/3/00 at par. d1) 6¼% to 16/3/00, then 6%. f) Eonia +6bp. g) 3-mth Euribor +12½bp. h) Fungible with €300m. Plus 43 days accrued. § Fixing Tuesday: Indicated conversion premium 28-32% and redemption price 113.7-117.3%. Callable after 3 yrs at accreted value. ¶ Quarterly. k) Short 1st coupon.

Posit finds favour with UK investors

By Vincent Boland

Posit, an electronic order-matching system for buying and selling shares, said yesterday it had captured orders worth £15.5bn in UK stocks since it began operations three months ago, reflecting a growing trend among investors towards using alternative trading systems to complement their activity on the stock exchange.

The Posit system, which has been matching "buy" and "sell" orders in the US since 1987 and began operating in Europe on November 18, now claims to be receiving orders for matching worth £250m daily, of which 44 per cent is in the shares of constituent companies of the FTSE 100 index.

Under the Posit system, an investor enters a "buy" or "sell" order which is matched twice a day with orders in the same stock from other investors at a pre-determined price.

Such systems have become popular with investors seeking anonymity, including the big fund management groups that want to eliminate the impact on share prices of their presence in the market.

The system is also often used by investors wishing to buy or sell shares of smaller-capitalisation companies without alerting competitors in the market to their activities. Some 90 per cent of Posit's daily business is from institutional investors, with about 60 per cent of its clients based in the UK.

The Posit system is operated in London by ITG Europe, a joint venture between ITG Group, the US technology group, and Société Générale, the French bank.

Alasdair Haynes, chief executive, said there were plans to operate in all European markets over time, starting with Paris and Frankfurt.

Mr Haynes said 70 London-based investors were regular users of the Posit system and he expected up to three "very major clients" would be joining in the next two weeks.

He declined to say what proportion of the £15.5bn worth of orders entered by investors had been executed but said the company was "not disappointed" by the amount of business being done: "It is very much along the lines of what we had expected and on a par with our volumes in the US."

The orders represent some 6.3bn shares, of which 18 per cent are shares of FTSE 100 companies. In terms of value, 40 per cent of the orders represent FTSE 250 companies, with the remainder for other quoted companies.

Alternative trading systems are common in the US markets, where Posit competes with the likes of Instinet and other broking and technology firms, and are now beginning to make an impact in Europe.

According to ITG Europe, 87 per cent of all US institutions and 82 per cent of those that manage assets over $5bn use alternative trading systems.

In addition, many of the big investment banks and fund management groups are developing their own trading systems to match "buy" and "sell" orders.

WORLD BOND PRICES

BENCHMARK GOVERNMENT BONDS

Feb 25	Red Date	Coupon	Bid Price	Bid Yield	Day chg yield	Wk chg yield	Month chg yld	Year chg yld
Australia	01/01	8.750	106.5236	5.04	+0.07	+0.15	+0.34	−0.17
	08/08	8.750	122.5486	5.52	+0.10	+0.32	+0.59	−0.38
Austria	03/01	5.250	103.9700	3.20	+0.09	+0.16	+0.23	−0.85
	01/08	5.000	106.5400	4.10	+0.08	+0.05	+0.30	−0.94
Belgium	03/01	5.000	103.6800	3.13	+0.06	+0.23	+0.20	−0.91
	03/09	3.750	96.5800	4.17	+0.05	+0.05	+0.32	−0.84
Canada	12/00	[illegible]	[illegible]	5.25	+0.06	+0.22	+0.47	+0.17
	06/08	6.000	104.5000	5.37	+0.10	+0.23	+0.44	−0.08
Denmark	11/00	9.000	108.8200	3.53	+0.07	−0.01	+0.14	−0.60
	11/09	6.000	113.8700	4.35	+0.08	+0.12	+0.58	−0.90
Finland	06/00	4.000	101.2210	3.02	+0.03	+0.01	+0.13	−0.82
	04/09	5.000	106.8120	4.15	+0.06	+0.04	+0.31	−0.80
France	07/00	4.000	101.2400	3.04	+0.04	+0.01	+0.17	−0.81
	04/03	[illegible]	[illegible]	3.70	+0.08	+0.08	+0.33	−0.87
	04/08	4.000	99.5800	4.05	+0.08	+0.06	+0.37	−0.89
	04/29	5.500	109.0000	4.92	+0.09	+0.04	+0.35	−0.85
Germany	05/01	5.000	104.0600	3.07	+0.06	+0.09	+0.16	−0.76
	01/03	8.000	112.9300	3.61	+0.09	+0.10	+0.35	−0.91
	01/08	3.750	98.3000	3.96	+0.09	+0.02	+0.30	−0.96
	07/28	4.750	97.6400	4.90	+0.08	+0.04	+0.32	−0.80
Greece	03/00	8.800	100.2684	8.51	+0.04	−0.11	−0.46	−3.70
	01/09	6.300	102.3300	5.98	+0.02	−0.20	−0.35	−4.92
Ireland	10/01	6.500	108.1700	3.22	+0.06	+0.02	+0.19	−1.86
	08/08	6.000	114.4800	4.12	+0.07	+0.01	+0.28	−1.06
Italy	07/01	4.500	102.8800	3.20	+0.07	+0.07	+0.23	−1.49
	07/03	4.500	103.9900	3.51	+0.09	+0.03	+0.25	−1.35
	05/08	4.500	103.0000	4.13	+0.08	+0.01	+0.27	−1.16
	11/27	6.500	121.3200	5.08	+0.09	+0.02	+0.30	−0.72
Japan	12/00	6.900	111.7540	0.33	+0.01	–	−0.23	−0.39
	12/03	4.100	113.9060	1.12	+0.03	−0.01	−0.12	−0.16
	06/08	1.900	98.1780	1.90	+0.03	+0.03	+0.17	+0.18
	09/18	2.300	92.2830	2.82	+0.03	+0.01	+0.28	+0.29
Netherlands	01/01	9.000	110.5800	3.09	+0.08	+0.16	+0.18	−0.88
	07/08	3.750	97.0500	4.10	+0.13	+0.09	+0.35	−0.78
New Zealand	02/01	8.000	105.2491	5.10	+0.07	+0.18	+0.07	−2.59
	07/09	7.000	109.4838	5.77	+0.05	+0.25	+0.27	−1.19
Norway	05/01	7.000	104.1200	5.00	+0.08	+0.12	−0.35	+0.85
	05/09	5.500	105.3000	4.83	+0.07	+0.05	−0.03	−0.58
Portugal	03/00	5.375	102.3900	3.03	+0.05	−0.02	+0.09	−7.04
	06/08	5.375	109.2400	4.15	+0.08	+0.04	+0.39	−1.00
Spain	01/01	5.000	103.5800	3.04	+0.08	−0.01	+0.15	−1.16
	07/09	5.150	105.8800	4.43	+0.09	+0.33	+0.61	−0.70
Sweden	05/00	10.250	107.8474	3.28	+0.02	+0.05	+0.04	−1.33
	05/08	6.500	116.5780	4.27	+0.08	+0.06	+0.34	−1.13
Switzerland	06/00	4.500	103.9400	1.34	+0.04	−0.05	−0.01	−0.02
	01/08	4.250	118.1000	2.22	+0.02	−0.10	−0.03	−0.54
UK	11/01	7.000	105.4500	4.81	+0.11	+0.04	+0.22	−1.80
	12/03	6.500	106.1400	4.58	+0.14	+0.06	+0.35	−1.57
	12/09	5.750	110.4900	4.61	+0.18	–	+0.32	−1.58
	12/28	6.000	125.1900	4.46	+0.10	+0.09	+0.27	−1.51
US	01/01	4.500	98.7810	5.18	+0.09	+0.23	+0.61	−0.40
	02/04	4.750	97.9060	5.23	+0.11	+0.17	+0.58	−0.46
	11/08	4.750	95.8750	5.30	+0.12	+0.15	+0.52	−0.38
	02/29	5.250	94.9375	5.60	+0.09	+0.05	+0.39	−0.35

London closing. * New York mid day. Source: Interactive Data/FT Information
Yields: Local market standard/Annualised yield basis. Yields shown for Italy exclude withholding tax at 12.5 per cent payable by nonresidents.

10 YEAR BENCHMARK SPREADS

Feb 25	Bid Yield	Spread vs Euros	Spread vs T-Bonds		Bid Yield	Spread vs Euros	Spread vs T-Bonds
Australia	5.53	+1.57	+0.25	Netherlands	4.11	+0.15	−1.17
Austria	4.23	+0.27	−1.05	New Zealand	5.78	+1.82	+0.50
Belgium	4.14	+0.18	−1.14	Norway	4.83	+0.87	−0.45
Canada	5.38	+1.42	+0.10	Portugal	4.21	+0.25	−1.07
Denmark	4.29	+0.33	−0.99	Spain	4.24	+0.28	−1.04
Finland	4.14	+0.18	−1.14	Sweden	4.30	+0.34	−0.98
France	4.02	+0.06	−1.26	Switzerland	2.39	−1.57	−2.89
Germany	3.96	–	−1.32	UK	4.56	+0.60	−0.72
Greece	6.13	+2.17	+0.85	US	5.28	+1.32	–
Ireland	4.15	+0.19	−1.13				
Italy	4.16	+0.20	−1.12				
Japan	1.94	−2.02	−3.34				

Source: Interactive Data/FT Information
London closing. * New York closing.
Annualised yield basis.

EMERGING MARKET BONDS

Feb 25	Red date	Coupn	S & P Rating	Bid price	Bid yield	Day's chge yld	Mth's chge yld	Sprd vs US
EUROPE								
Croatia	02/02	7.000	BBB–	93.5838	9.52	+0.27	−0.16	+4.36
Poland	07/04	7.125	BBB–	105.2828	5.93	+0.08	−0.07	+0.70
Russia	06/07	10.000	n/a	28.4400	42.01	+0.48	+0.18	+37.35
LATIN AMERICA								
Argentina	09/27	9.750	BB	81.1754	12.10	+0.16	−0.36	+6.58
Brazil	05/27	10.125	B+	63.5921	16.03	+0.61	−1.49	+10.46
Mexico	05/26	11.500	BB	104.8540	10.93	+0.06	−0.31	+5.37
ASIA								
China	07/06	7.750	BBB+	99.8850	7.78	+0.32	+0.20	+2.51
Philippines	10/16	8.750	BB+	89.6075	10.01	+0.27	+0.05	+4.81
Thailand	04/07	7.750	BBB–	98.3508	8.03	+0.27	+0.30	+2.77
AFRICA/MIDDLE EAST								
Lebanon	07/00	9.125	BB–	102.1100	7.42	+0.08	+0.41	+2.28
South Africa	10/06	8.375	BB+	94.4293	9.41	+0.17	−0.51	+4.16
Turkey	08/07	10.000	B	88.4719	12.22	+0.22	+0.65	+8.96
BRADY BONDS								
Argentina	03/23	5.750	BB	66.7500	9.55	+0.31	−0.17	+4.04
Brazil	04/14	5.000	B+	56.6250	14.73	+0.56	−1.23	+9.37
Mexico	12/19	6.250	BB	74.2500	9.01	+0.21	−0.06	+3.87
Venezuela	03/20	6.750	B+	62.8750	11.45	+0.27	+0.10	+5.99

London closing. Prices in US$. Standard & Poor's ratings. Source: Interactive Data/FT Information.

BOND FUTURES AND OPTIONS

France

■ NOTIONAL EURO BOND FUTURES (MATIF) €100,000

	Open	Sett price	Change	High	Low	Est. vol.	Open int.
Mar	111.22	110.92	−0.81	111.29	110.81	39,091	87,287

■ LONG TERM EURO BOND OPTIONS (MATIF)

Strike Price	CALLS Mar	CALLS Jun	CALLS –	PUTS Mar	PUTS Jun	PUTS –
109	2.73	-	-	-	-	-
110	1.73	-	-	-	-	-
111	0.74	-	-	0.01	-	-
112	0.08	-	-	0.35	-	-

Est. vol. total, Calls n/a Puts n/a . Previous day's open int., Calls n/a Puts n/a .

Germany

■ NOTIONAL GERMAN BUND FUTURES (DTB) DM250,000 100ths of 100%

	Open	Sett price	Change	High	Low	Est. vol	Open int.
Mar	115.50	114.54	−1.27	115.64	114.45	807,250	517,028

■ NOTIONAL GERMAN EURO (BOBL) FUTURES (DTB) DM250,000 100ths of 100%

	Open	Sett price	Change	High	Low	Est. vol	Open int.
Mar	108.83	108.54	−0.45	108.96	108.43	202,057	231,975

■ NOTIONAL LFB SWAP FUTURES (LIFFE)* 5yr 4.0% DM250,000 points of 100%

	Open	Sett price	Change	High	Low	Est. vol	Open int.
Mar	-	101.47	-0.27	-	-	0	1015

■ NOTIONAL LFB SWAP FUTURES (LIFFE)* 10yr 4.5% DM250,000 points of 100%

	Open	Sett price	Change	High	Low	Est. vol	Open int.
Mar	-	101.92	-0.58	-	-	0	940

Also traded on APT. All Open Interest figs. are for previous day.

Italy

■ NOTIONAL ITALIAN GOVT. BOND (BTP) FUTURES (LIFFE)* Lira 200m 100ths of 100%

	Open	Sett price	Change	High	Low	Est. vol	Open int.
Mar	113.67	113.14	-0.73	113.67	112.64	19083	44744

Spain

■ NOTIONAL SPANISH BOND FUTURES (MEFF) €100,000

	Open	Sett price	Change	High	Low	Est. vol.	Open int.
Mar	116.60	116.14	−0.72	116.71	116.05	23,958	22,176
Jun	–	98.16	−0.64	–	–	–	–

UK

■ NOTIONAL 5 YEAR GILT FUTURES (LIFFE) £100,000 100ths of 100%

	Open	Sett price	Change	High	Low	Est. vol	Open int.
Mar	-	108.56	-0.03	-	-	0	63
Jun	-	108.35	-0.03	-	-	0	0

■ NOTIONAL UK GILT FUTURES (LIFFE)* £100,000 100ths of 100%

	Open	Close	Change	High	Low	Est. vol	Open int.
Mar	117.60	116.55	-1.12	117.62	116.03	55256	32203
Jun	118.58	117.21	-1.57	118.58	116.66	44025	59166

* LIFFE futures also traded on APT. All Open Interest figs. are for previous day.

■ LONG GILT FUTURES OPTIONS (LIFFE) £100,000 100ths of 100%

Strike Price	CALLS Jun	CALLS Sep	PUTS Jun	PUTS Sep
11650	1.85	2.50	1.14	1.79
11700	1.56	2.24	1.35	2.03
11750	1.32	2.00	1.62	2.29
11800	1.11	1.77	1.90	2.56
11850	0.91	1.56	2.20	2.85
11900	0.74	1.37	2.53	3.16

Est. vol. total, Calls 0 Puts 206. Previous day's open int., Calls 6396 Puts 2469

US

■ US TREASURY BOND FUTURES (CBT) $100,000 32nds of 100%

	Open	Latest	Change	High	Low	Est. vol.	Open int.
Mar	121–28	121–16	−0–11	122–05	121–17	432,729	436,505
Jun	121–12	121–02	−0–11	121–20	121–02	145,906	306,352
Sep	–	120–31	–	–	–	140	8,646

Japan

■ NOTIONAL LONG TERM JAPANESE GOVT. BOND FUTURES (LIFFE) Y100m 100ths of 100%

	Open	Sett price	Change	High	Low	Est. vol	Open int.
Mar	131.10	130.92	-	131.17	130.90	2515	n/a
Jun	129.90	129.77	-	129.99	129.77	775	n/a

Euro

■ € BUND FUTURES (MATIF) €100,000

	Open	Sett price	Change	High	Low	Est. vol.	Open int.
Mar	109.30	108.90	−1.44	109.30	109.30	1	181

US CORPORATE BONDS

Feb 24	Red date	Coupn	S & P Rating	Bid price	Bid yield	Day's chge yld	Mth's chge yld	Bond v Govts
UTILITIES								
Pac Bell	07/02	7.25	AA–	104.7348	5.68	+0.11	+0.42	+0.66
NY Tel	08/25	7.00	A+	99.2282	7.06	+0.05	+0.36	+1.56
CWE	09/08	8.60	BBB	112.6924	6.17	+0.07	+0.37	+1.00
FINANCIALS								
GECC	05/07	8.75	AAA	117.8393	5.67	+0.08	+0.45	+0.60
Banc One	08/02	7.25	A	104.2125	5.86	+0.06	+0.23	+0.88
CNA Fin	01/18	6.95	A–	93.2941	7.62	+0.09	+0.50	+2.12
INDUSTRIALS								
WMX Tech	04/00	6.25	BBB+	100.0210	5.84	−0.05	+0.07	+1.24
Wal Mart	08/02	6.75	AA	104.1782	5.31	+0.09	+0.35	+0.31
Dayton Hud	08/21	8.70	A–	133.3887	6.77	+0.12	+0.24	+1.27
AGENCIES								
FHLMC	04/07	7.14	NA	108.1332	5.71	+0.07	+0.38	+0.54
SLMA	03/00	7.80	NA	102.2716	5.21	+0.02	+0.10	+0.61
FNMA	02/16	8.95	NA	132.4004	6.05	+0.09	+0.39	+0.65
FFCB	09/06	8.95	NA	119.3650	5.65	+0.07	+0.41	+0.48
HIGH YIELD								
Stone Cont	02/01	9.88	B	101.8760	0.00	–	–	–
AK Stl	12/01	9.13	BB–	106.1250	0.00	–	–	–
Pacella	08/04	10.75	B–	89.0000	0.00	–	–	–

NY Interest. Standard & Poor's ratings. Yields: semi-annual basis. Source: Interactive Data/FT Information.

US INTEREST RATES

Latest — Treasury Bills and Bond Yields

Prime rate	7¾	One month	-	Two year	5.15
Broker loan rate	6¼	Two month	-	Three year	5.16
Fed.funds	4⅝	Three month	4.65	Five year	5.21
Fed.funds at intervention		Six month	4.72	10-year	5.28
		One year	4.86	30-year	5.59

INTERNATIONAL BONDS

Feb 25	Red date	Coupon	S & P Rating	Bid price	Bid yld	Day's chge yld	Mth's chge yld	Spread v Govts
US DOLLAR								
EIB	04/07	7.250	AAA	107.4810	6.06	+0.27	+0.55	+0.80
ABN Amro	06/07	7.125	AA–	103.7052	6.51	+0.11	+0.02	+1.25
Quebec	01/07	7.000	A+	105.1800	6.16	−0.01	+0.14	+0.90
Citicorp FRN	02/04	5.066	AA–	99.9280	5.39	−0.35	−1.37	+0.06
EURO								
Bayer L–Bk	08/04	8.500	AAA	116.5429	5.65	+0.16	+0.52	+0.21
Toronto (M of)	06/04	8.500	AA+	111.9464	5.78	+0.20	+0.51	+0.14
Bell Canada	07/26	10.625	A+	101.6594	5.85	+0.12	+0.44	+1.26
Deutsche B FRN	09/02	5.875	AA+	99.9842	5.60	+0.16	+0.45	+0.33
STERLING								
EIB	12/07	7.625	AAA	117.3928	5.11	+0.09	+0.25	+0.42
Dresdner Bk	12/07	7.750	AA–	112.0846	5.94	+0.14	+0.12	+1.25
British Gas	03/00	7.625	A+	102.0100	5.64	+0.07	–	+0.82
Abbey Nat FRN	03/02	5.687	AA	100.0317	4.36	+0.12	+0.00	−0.43
SFR								
EIB	01/08	3.750	AAA	104.2017	3.20	+0.03	−0.05	+0.98
Brit Columbia	02/02	3.250	AA	103.9088	1.88	+0.01	−0.03	+0.29
Hydro–Quebec	08/01	6.750	n/a	109.0236	2.51	+0.02	−0.01	+1.06
Gen Elect.	09/01	1.711	n/a	99.8328	1.47	+0.02	−0.01	+0.02
YEN								
IBRD (World Bk)	03/02	5.250	AAA	114.3910	0.49	+0.01	−0.15	−0.14
Spain (Kingdom)	03/02	5.750	AA	115.6932	0.56	+0.01	−0.16	−0.07
Cred Foncier	08/02	4.750	A	112.3443	1.07	+0.02	−0.19	+0.44
Italy (Rep of)	07/00	0.616	AA	100.0636	0.20	–	−0.17	+0.02
A$								
IBRD (World Bk)	02/06	6.000	AAA	100.4634	5.93	+0.10	+0.62	+0.42
New Sth Wales Tr	05/06	6.500	n/a	103.3116	5.92	+0.09	+0.57	+0.52
S. Aus Gov Fin	06/03	7.750	AA	108.7891	5.91	+0.07	+0.38	+0.73
GMAC Aust	05/01	9.000	n/a	106.5918	5.74	+0.05	+0.24	+0.72

London closing. Standard & Poor's ratings. Yields: Local market standard/Annualised basis. Source: Interactive Data/FT Information

UK BONDS

FTSE Actuaries Government Securities — UK Indices

Price Indices UK Gilts	Thu Feb 25	Day's chge %	Accrued interest	xd adj ytd	Total Return	Duration Years	Duration Yield	% Weight
1 Up to 5 years (16)	121.03	−0.28	1.66	1.79	1202.88	2.35	4.78	34.13
2 5-10 years (11)	170.48	−0.82	2.59	1.00	1328.45	5.91	4.66	29.38
3 10-15 years (7)	184.64	−1.07	2.18	1.34	1446.34	8.71	4.62	13.51
4 5-15 years (18)	174.57	−0.90	2.48	1.10	1362.21	6.79	4.64	42.87
5 Over 15 years (4)	229.64	−1.13	2.26	1.23	1559.48	11.94	4.59	22.24
6 Irredeemables (1)	[illegible]							
7 All stocks (42)	[illegible]							

Index-linked	Thu Feb 25	Day's chge %	Accrued interest	xd adj ytd	Total Return	% Weight
1 Up to 5 years (2)	225.18	−0.12	1.94	0.00	1169.41	15.02
2 Over 5 years (9)	257.92	−0.33	0.89	2.15	1401.03	84.98
3 5-15 years (5)	240.67	−0.28	0.89	2.03	1302.90	42.70
4 Over 15 years (4)	273.87	−0.39	1.12	2.29	1491.82	42.29
5 All stocks (11)	251.85	[illegible]	[illegible]	[illegible]	[illegible]	100.00

Yield indices: [illegible]

FT Fixed Interest Indices: [illegible]

UK GILTS PRICES

[illegible]

Other Fixed Interest

[illegible]

Posit finds favour with UK investors

CURRENCIES & MONEY

Dollar slides as Mr Yen keeps mum

MARKETS REPORT

By Alan Beattie

The dollar fell back to the Y120 level against the yen yesterday as US and Japanese officials would not be drawn on a suitable level for the exchange rate.

Eisuke Sakakibara, the vice finance minister for international affairs known as Mr Yen, claimed that dollar-yen movements were not discussed at yesterday's meeting of the "Six Markets Group" of Asia-Pacific countries, which includes the US.

This disappointed some traders, who had been hoping Mr Sakakibara might indicate his preferred level for the yen against the dollar. The dollar lost some of its recent gains, closing in London at Y120.1 against the yen.

But few analysts were prepared to infer another policy change from the silence out of Japan. "It is hard to believe that the Six Markets Group did not discuss dollar-yen at all," said Gerard Lyons, chief economist at DKB International in London. "But the Japanese seem to have settled for a stable but somewhat weaker yen, in the Y120-125 or even Y120-130 range," he added.

With dollar assets looking less attractive, the yen-dollar rate might well stay around the Y120 level "by default," Mr Lyons said.

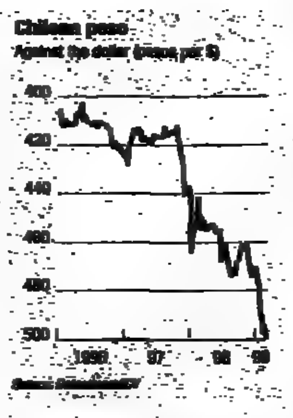
■ *The Chilean* peso dropped yesterday as the prospect of diminished equity-related capital inflows compounded the fall-out from Brazil.

The peso opened lower after shareholders in Enersis, the Chilean electricity company, voted against allowing the limit for a single shareholder to rise from 32 to 65 per cent of the company. This scuppered the planned takeover of Enersis by Endesa, the Spanish energy company, and disappointed those traders who had already priced in a large capital inflow as a consequence of the takeover.

The peso depreciated below the 500 peso level against the dollar, before appreciating to just above that level by the London close.

Analysts said that the peso, which has already fallen rapidly this year, was vulnerable because of the recent currency turmoil in Brazil.

"Chile's high dependence on intra-regional trade, added to the fact that monetary policy is on a loosening path, means that any large external shock is likely to lead to the peso devaluing," said David Lubin, emerging markets economist at HSBC.



■ Trading in the Brazilian Real itself remained tense and wary yesterday.

Markets were waiting for today's senatorial hearings into the appointment of Arminio Fraga to the governorship of the central bank, and President Cardoso's meeting with opposition state governors.

The Real opened a touch higher, although still below R$2.00, and stayed around that level until the end of London trading.

David Lubin said that the key determinant for future movements in the Real would be the terms of the fiscal package attached to the IMF deal.

"The market doubts that the government's primary surplus will be enough to offset the fiscal cost of the crisis," Mr Lubin added.

Mr Lubin said that Brazil faced a different version of the dilemma Asian countries encountered in 1997.

"The Asian vicious circle was currency collapse leading to higher interest rates and then to capital flight because of the effect on corporate balance sheets," he said.

"But in Brazil's case capital flight follows the effect of higher interest rates on public sector finances," Mr Lubin said. "The public sector is at the heart of Brazil's problems," he added.

■ The Vietnamese central bank took a small step towards a free-floating dong yesterday, announcing it would allow the currency to move gradually over time.

Until now the dong moved within a 7 per cent trading band, with the mid-point set by the central bank. But there has been pressure for a new system, after a series of devaluations since mid-1997 forced by emerging market turmoil in the region.

The dong will now be allowed to rise or fall by up to 0.1 per cent daily, with the mid-point each day set by the previous day's interbank market rate.

■ POUND IN NEW YORK

Feb 25	—Latest—	— Prev. close —
£ spot	1.6080	1.5985
1 mth	[illegible]	1.5957
3 mth	1.6045	1.5951
1 yr	1.6080	1.5990

■ OTHER CURRENCIES

Feb 25	£	$
Czech Rp	55.0025 - 55.1015	34.2540 - 34.3440
Hungary	357.701 - 360.250	220.230 - 222.500
Iran	4819.20 - 4810.50	3000.00 - 3000.00
Kuwait	0.4886 - 0.4898	0.3047 - 0.3048
Peru	5.5080 - 5.5175	3.4350 - 3.4390
Poland	6.2424 - 6.2620	3.8830 - 3.8980
Russia	36.7352 - 37.1750	22.9100 - 23.1700
U.A.E.	5.8865 - 5.8894	3.6720 - 3.6720

POUND SPOT FORWARD AGAINST THE POUND

Feb 25		Closing mid-point	Change on day	Bid/offer spread	Day's Mid high	Day's Mid low	One month Rate	One month %PA	Three months Rate	Three months %PA	One year Rate	One year %PA	Bank of Eng. Index
Europe													
Austria	(Sch)	19.9718	-0.1131	626 - 810	20.0314	19.9422	19.9314	2.4	19.869	2.3	19.562	2.1	102.4
Belgium	(BFr)	58.5488	-0.3316	220 - 766	58.7250	58.4640	58.4311	2.4	58.216	2.3	57.3180	2.1	102.6
Denmark	(DKr)	10.7901	[illegible]	[illegible]	10.8334	10.7708	10.7698	2.3	10.7365	1.9	10.6041	1.7	108.0
Finland	(FM)	8.6207	[illegible]	[illegible]	8.6550	8.6170	8.6128	2.4	8.5985	[illegible]	8.4483	2.1	81.5
France	(FFr)	9.5208	[illegible]	[illegible]	9.5491	9.5068	9.5013	2.4	9.4669	2.3	9.3394	2.1	105.9

DOLLAR SPOT FORWARD AGAINST THE DOLLAR

Feb 25		Closing mid-point	Change on day	Bid/offer spread	Day's mid high	Day's mid low	One month Rate	One month %PA	Three months Rate	Three months %PA	One year Rate	One year %PA	J.P. Morgan Index
Europe													
Austria	(Sch)	12.4517	-0.1108	[illegible]	12.6364	12.4404	12.4332	1.8	12.3924	1.9	12.1752	2.2	102.5
Belgium	(BFr)	36.5004	-0.3240	[illegible]	36.7230	36.4700	36.4480	1.8	36.3295	1.9	35.6827	2.2	102.5
Denmark	(DKr)	6.7272	-0.0588	252 - 292	6.7791	6.7214	6.718	1.7	6.7013	1.5	6.6032	1.8	105.1
Finland	(FM)	5.3908	-0.0477	793 - 812	5.4128	5.3754	5.3723	1.8	[illegible]	1.9	5.2808	2.2	80.7
France	(FFr)	5.9358	-0.0526	347 - 369	5.9714	5.9304	5.9289	1.8	5.9075	1.9	5.804	2.2	105.3

WORLD INTEREST RATES

MONEY RATES

INTERNATIONAL CURRENCY RATES

CROSS RATES AND DERIVATIVES

EXCHANGE CROSS RATES

UK INTEREST RATES

LONDON MONEY RATES

EMS EUROPEAN CURRENCY UNIT RATES

BASE LENDING RATES

COMMODITIES & AGRICULTURE

Norway in move to buoy oil industry

By Valeria Sköld in Oslo

Norway, the world's second largest oil exporter, is considering further cuts in oil production and changes to its legal and fiscal framework in an effort to support its ailing oil industry.

Ministers will meet trade union, oil company and industry representatives today to discuss a number of measures aimed at countering the effects of low crude prices.

The gathering follows a week in which all three Norwegian oil companies announced disappointing 1998 results, thousands of expected job losses and billions of krone in exploration cuts, as the country bears down for a recession after five years of strong growth.

Norway's labour directorate said yesterday it expected that increasing job cuts – particularly from oil-related industries – would raise the number of registered unemployed by 15,000, or 26 per cent, to 73,000.

The oil ministry is considering lowering oil industry taxes, relaxing the exploration licensing policy and offering new offshore acreage, said Erlend Grimstad, deputy minister of oil and energy.

"We don't foresee that any measures on a national scale will solve the problem for the oil industry," Mr Grimstad said. "The main challenge is the historically low oil price."

The ministry is also considering reducing Norway's expected oil output of 3.05m barrels a day this year, including its current production cuts which expire this June.

Norway, which is not a member of the Organisation of Petroleum Exporting Countries, implemented a 100,000 barrel-a-day production cut in May, which was renewed in December.

The country will base its decision about further reductions on other producing countries' compliance with cuts and willingness to take further reductions, Mr Grimstad said.

He declined to say whether the changes would weaken the planned NKr9bn ($1.14bn) in fiscal tightening in the 1999 budget.

However, he revealed the government would consider raising taxes elsewhere or transferring less to the country's petroleum fund.

The fund is the surplus of oil revenues saved to finance Norway's ageing population as the country's petroleum wealth declines.

Irrigation plan proves mixed blessing for Turkish farmers

Scheme has generated its own problems, reports **Leyla Boulton**

Mahmut Dincol, a Turkish farmer who lives near the Syrian border, keeps his motorcycle and the empty box for his television in the mud hut which used to be his home. Since the Harran plain which he farms has been irrigated, Mr Dincol has built himself a one-storey house made of concrete.

"Our life has been good since irrigation. People who had a horse and cart now have a car and tractor, and those who did not have a house have built one," he says.

The irrigation has come courtesy of the $32bn southeastern Anatolia project (GAP). Its aim is to narrow the divide between Turkey's more prosperous western half and its backward southeastern region, scene of the 15-year war between the armed forces and the Kurdish PKK guerrilla movement.

By damming the Euphrates and Tigris rivers to generate electricity and store water for irrigation, Turkey aims to raise local income levels to 60 per cent of the national average by 2005.

Officials say that without it, the area would fall even further behind the rest of the nation. Of 22 dams planned under the project, five have already been completed at the cost of flooding 144 villages.

The results of the scheme have been mixed. Attempts to build dams in areas where the Kurdish majority is heaviest have been disrupted by PKK attacks.

The fact that electricity produced so far has gone mainly to the west means that power cuts continue to complicate efforts to start up the local agro-industries that are essential to the GAP's success. Such industries are seen as the only way of taking more farmers off the land in order to make agriculture more efficient.

However, the very agricultural revolution planners want to set in train is at risk from the project itself.

Erkan Alemdaroglu, the US-educated irrigation engineer who is the GAP's regional director, says a "master plan" for the project is to be revised this year in a bid to correct some of the mistakes that have come to light in the 10 years since the strategy was drawn up.

The most pressing threat to GAP's long-term success is a build-up of salt from excessive water used by farmers, and a lack of evacuation channels for irrigation water. If unchecked, it will ruin the land.

Mr Alemdaroglu says Turkey also needs to drop surface irrigation in favour of pump-irrigation. The impermeable sub-soil of the region does not allow water to seep away through natural watercourses.

Signs on concrete troughs carrying water to the fields on either side of the road to the Syrian border from Urfa, the biggest town near Harran, exhort farmers to use less water.

But Mr Alemdaroglu argues that the scant attention paid to such warnings suggests the state needs to use financial incentives to change the behaviour of farmers.

Free agricultural training offered by the state has been insufficiently staffed and largely ineffective. Charging the equivalent of $100 a year would be affordable to farmers who make an average of $205 per hectare a year from farms averaging 90 hectares, particularly if the improved practices they learnt boosted their incomes further.

To kickstart the process, the state could also tie cheap loans to farmers' willingness to sign up to the new courses.

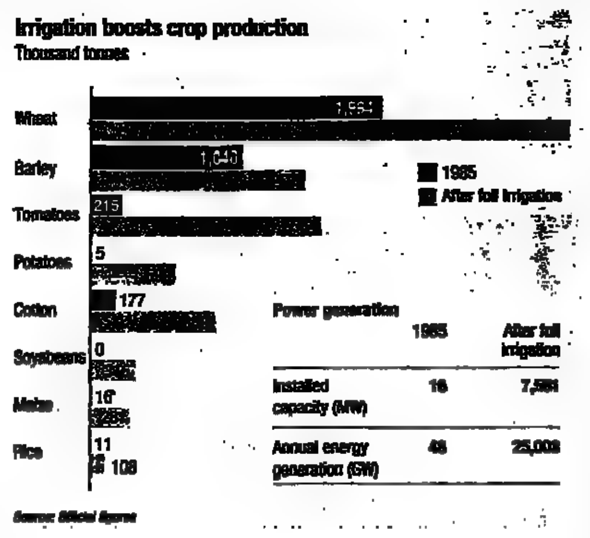
In trying to change farmers' attitudes, Mr Alemdaroglu has unexpectedly obtained a new ally – a sharp fall in cotton prices that has accompanied a contraction in Turkey's textiles industry.

The low prices give him hope that he will be able to persuade farmers to stop focusing on cotton, which uses a lot of water, in favour of less water-hungry crops.

Another challenge is securing access to new markets for the extra produce that is grown as a result of the GAP. Turkey reckons it will need only 5 per cent of the additional produce, making the Middle East and north Africa prime candidates for increased food exports.

But trade with Iran and Armenia remains difficult for political reasons, while there is room for improvement in Turkey's economic ties with its two other neighbours, Syria and Iraq, which are hamstrung by United Nations sanctions.

The GAP has been an important irritant in Turkey's relations with Syria and Iraq, who argue it reduces their access to water from rivers which flow into their territory from Turkey.



LME ends curbs on rollover premiums

MARKETS REPORT

By Gillian O'Connor, Robert Corzine and Paul Solman

The London Metal Exchange yesterday withdrew all curbs on metal price rollover premiums with effect from March 1, but warned market participants not to abuse their new freedom. These curbs stop firms using dominant positions to squeeze supplies.

Official interventions in the aluminium and lead markets earlier this year provoked considerable opposition from traditionalists, who regard squeezes as part of the everyday rough and tumble of markets. They argued that by imposing curbs the exchange officials were favouring firms that had sold short.

After yesterday's announcement some traders started talking of an imminent squeeze in zinc. Conspiracy theorists suggested that one big merchant had been using the aluminium and lead markets for practice runs, and was now moving in for the kill in zinc.

The LME had earlier warned it would not hesitate to act "if an improper market or other undesirable situation emerges".

The price of April Brent oil futures swung around the $11 a barrel mark for much of yesterday. In late trading on London's International Petroleum Exchange April Brent was quoted at $11.12 a barrel, 4 cents up on Wednesday's settlement price, although at one point it fell as low as $10.86.

Continuing weakness in world oilseed markets knocked European rapeseed prices to a new low yesterday. The May contract on Matif ended at €180.5 a tonne. The previous record low of €181 was reached on Monday.

Rio Tinto may hold back on production cuts

By Gillian O'Connor
Mining Correspondent

What makes sense for an individual company is "lunacy" for the industry as a whole, admitted Rio Tinto chairman Bill Wilson yesterday, in a conference to discuss the group's results.

His topic, unsurprisingly, was mine production cuts, and he was explaining why Rio owes it to its shareholders not to bear the industry's burden by cutting its own capacity.

If every individual company takes the same line, the industry as a whole will drown in the surplus. But as a low cost producer Rio can afford to sit and wait until its competitors bite the bullet.

He reckons copper cutbacks of 400,000 to 500,000 tonnes a year are needed to restore the market to balance. Despite the short-term pain to Rio involved, he is hoping that prices will stay low enough long enough to achieve this. The clutch of high cost operations in the south-west United States could be the first to give.

David Humphreys, the group's chief economist, took up the theme in more detail. His broad thesis is that short-term prospects for metal prices depend on producer behaviour since no pick up in demand is likely. Any growth will be "the wrong kind of growth" for metal producers.

The background in this downwards swing of the cycle is slightly different from that obtaining in previous ones, in that the mining industry did not put on excess weight in the good times.

Employment levels in the US copper industry were virtually the same in 1989 and 1997, even though production rose by a third. So there is only limited scope this time to pare costs by wholesale measures such as job cuts. "Companies have generally got used to living closer to the edge of their human and physical capacity."

What this should mean, argues Mr Humphreys, is "a shorter nerve connecting the price stimulus and the producer response". In other words, production cuts soon.

But some producers are protected against falling metal prices by local currency depreciation against the US dollar. There is no hiding place for North American producers, which is one reason why a significant part of the 450,000 tonne copper capacity cuts committed in the past 15 months has occurred in North America.

The producer response in aluminium has been less than in copper, implying "that producers have some more to do if stocks are not to carry on rising as they have done so far this year".

He also highlights one of the factors which make the life of analysts attempting to forecast company profits so tricky: "prices have moved to the flatter part of the cost curve, that deeply unforgiving region where cost differences between producers are minimal and margins every bit as sensitive to the vacillations of exchange rates as of [metal] prices".

And where and when is the turning point? Here Mr Humphreys could double as the Delphic oracle. "... some sort of floor is close ... [but] floors can be virtual and ... prices frequently fall through them. Supposed floors can even become ceilings for a spell ... 1999 will probably not see the live cat bounce but it will be a critical year in determining when that bounce will occur."

COMMODITIES PRICES

BASE METALS

LONDON METAL EXCHANGE (Prices from Amalgamated Metal Trading)

ALUMINIUM, 99.7 PURITY ($ per tonne); ALUMINIUM ALLOY ($ per tonne); LEAD ($ per tonne); NICKEL ($ per tonne); TIN ($ per tonne); ZINC, special high grade ($ per tonne); COPPER, grade A ($ per tonne)

[illegible]

HIGH GRADE COPPER (COMEX)

[illegible]

PRECIOUS METALS

LONDON BULLION MARKET (Prices supplied by N M Rothschild)

[illegible]

Precious Metals continued

GOLD COMEX (100 Troy oz.; $/troy oz.)

	Sett price	Day's change	High	Low	Vol	Open int
Mar	286.4	-0.3	286.5	286.5	2	2
Apr	288.2	-	289.5	287.8	36,554	108.2k

[illegible]

PLATINUM NYMEX (50 Troy oz.; $/troy oz.); PALLADIUM NYMEX (100 Troy oz.; $/troy oz.); SILVER COMEX (5,000 Troy oz.; Cents/troy oz.)

[illegible]

ENERGY

CRUDE OIL NYMEX (1,000 barrels, $/barrel); CRUDE OIL IPE ($/barrel); HEATING OIL NYMEX (42,000 US galls.; c/US galls.); GAS OIL IPE ($/tonne); NATURAL GAS IPE (1,000 therms; pence per therm); NATURAL GAS NYMEX (10,000 mmBtu; $/mmBtu); UNLEADED GASOLINE NYMEX (42,000 US galls.; c/US galls.)

[illegible]

GRAINS AND OIL SEEDS

WHEAT LIFFE (100 tonnes; £ per tonne)

	Sett price	Day's change	High	Low	Vol	Open int
Mar	72.25	+0.50	72.25	72.25	16	116
May	75.00	+1.00	75.00	74.50	365	3,347

[illegible]

WHEAT CBT; MAIZE CBT; BARLEY LIFFE; SOYABEANS CBT; SOYABEAN OIL CBT; SOYABEAN MEAL CBT; POTATOES LIFFE; FREIGHT (BIFFEX) LIFFE

[illegible]

Feb	900	+15	895	895	3	170
Mar	1040	+10	1055	1040	60	216
Apr	1045	-	1055	1040	141	908
Jul	900	-5	910	905	21	615
Oct	1010	-10	-	-	-	373
Total					225	2,317

	Close	Prev
BFI	935	898

PULP AND PAPER

PULPEX OMLX (US$; 24 air dry tons)

	Sett price	Day's change	High	Low	Vol	Open int
Mar	403.00	+5.00	403.00	398.50	34	304
Jun	424.00	+3.50	424.00	421.50	12	339
Total					46	703

FUTURES DATA
All futures data supplied by CMS.

Wool from Mallett & Co
Superfine merino wool in Australia met good demand from a sector conscious that this was the last reasonably large offering of these types this season. Other merinos were firm, but crossbred wool prices were erratic at all sales this week, including New Zealand and at a Bradford auction of British wool. Clearances in Australia were better, but typically only two-thirds of offerings in New Zealand and Bradford went to the trade. The Australian eastern market indicator ended at 495 cents a kg, the New Zealand indicator at 386 cents, both a little higher than a week ago.

SOFTS

COCOA LIFFE (10 tonnes; £/tonne)

	Sett price	Day's change	High	Low	Vol	Open int
Mar	907	-18	920	906	2,352	13,648
May	907	-19	920	906	4,704	45,486

[illegible]

COCOA CSCE; COCOA (ICCO); COFFEE LIFFE; COFFEE 'C' CSCE; COFFEE (ICO); WHITE SUGAR LIFFE; SUGAR '11' CSCE; COTTON NYCE

[illegible]

ORANGE JUICE NYCE (15,000lbs; cents/lbs)

	Sett price	Day's change	High	Low	Vol	Open int
Mar	86.00	-4.00	89.75	85.00	1,349	5,497
May	83.30	-1.65	87.20	83.00	1,885	14,812
Jul	82.80	-1.15	85.75	82.50	192	4,890
Sep	82.10	-1.35	85.50	82.00	179	2,003
Nov	82.00	-1.10	84.25	82.25	41	1,344
Jan	82.50	-1.00	84.70	82.50	160	793
Total					3,832	29,162

VOLUME DATA
Open Interest and Volume data shown for contracts traded on COMEX, NYMEX, CBT, NYCE, CME, CSCE and IPE Crude Oil are one day in arrears. Volume & Open Interest totals are for all traded months.

INDICES

Reuters (Base: 18/9/31 = 100)

Feb 25	Feb 24	month ago	year ago
1432.6	1436.1	1443.9	1708.5

CRB Futures (Base: 1967 = 100)

Feb 24	Feb 23	month ago	year ago
184.66	186.21	-	-

GSCI Spot (Base: 1970 = 100)

Feb 24	Feb 23	month ago	year ago
132.70	133.09	133.45	163.47

LME WAREHOUSE STOCKS (tonnes)

Aluminium	-260	to	811,375
Aluminium alloy	-100	to	90,880
Copper	+275	to	594,700
Lead	+225	to	107,300
Nickel	-534	to	60,750
Zinc	+1,875	to	310,075
Tin	+160	to	7,700

MEAT AND LIVESTOCK

LIVE CATTLE CME (40,000lbs; cents/lbs); LEAN HOGS CME (40,000lbs; cents/lbs); PORK BELLIES CME (40,000lbs; cents/lbs)

[illegible]

LONDON TRADED OPTIONS

ALUMINIUM (99.7%) LME; COPPER (Grade A) LME; COFFEE LIFFE; COCOA LIFFE; BRENT CRUDE IPE

[illegible]

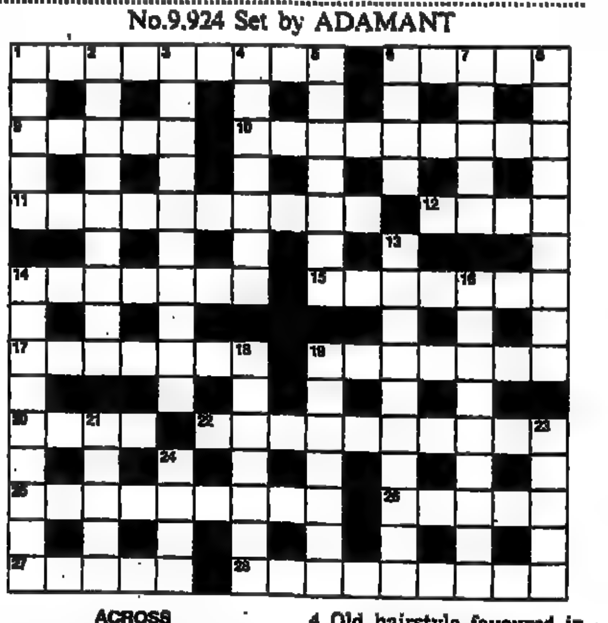
LONDON SPOT MARKETS

CRUDE OIL FOB (per barrel); OIL PRODUCTS NWE prompt delivery CIF (tonne); NATURAL GAS (Pence/therm); OTHER

[illegible]

CROSSWORD

No.9,924 Set by ADAMANT



ACROSS
1 Flier who did not survive the flight (4,5)
6 Funny decoration for commander-in-chief to accept (5)
9 Let the overall owner have a part (5)
10 Provide a diversion? Engineers are intent on it (9)
11 Bird trembling on her fencing (10)
12 Teacher on carpet over at university (4)
13 Outstanding, being without a board (7)
15 See how firm making comeback dies outside England (7)
17 Bank make mistake among volunteers at church (7)
19 Messenger in his element (7)
20 Spoken among the major allies (4)
22 Providing nourishment for foreign sailor swallowing first meal of year (10)
25 Silky haired creature will upset nag, or a malicious woman (6,3)
26 One jersey, for example, on the queen when it's colder (5)
27 Merry outing on German river (5)
28 They could have been an issue for Drake (9)

DOWN
1 Caught prisoner hiding new ring (5)
2 Hoarder's prayer for gold (9)
3 Dissension in Great Britain leading to a change of vessel (6,4)
4 Old hairstyle favoured in queen's household? (7)
5 Remarked that it was uncubed? (7)
6 Remedy for French priest (4)
7 Mother at Open University accepts one call from 25 (5)
8 Swindle the corporation and see the scornful insults (9)
13 Streaming down for production of Lear – torn it! (10)
14 Grand races for the citizens (9)
16 Learning of murder, due to Cain (9)
18 Material in the end can be twisted together (7)
19 Imitative quote on motorway madness initially coming up (7)
21 The audience predict it will be a bore (5)
23 Stories of how youth leader ran off on Sunday (5)
24 Nothing to pay – first ride is included in cost (4)

Solution 9,923

For solutions to today's crossword call 0891 430060. Calls cost 50p a minute.

FT MANAGED FUNDS SERVICE

● FT Cityline Unit Trust Prices are available over the telephone, Call the FT Cityline Help Desk on (+44 171) 873 4378 for more details.

OFFSHORE AND OVERSEAS

BERMUDA (FSA RECOGNISED)

Fidelity Currency Funds Ltd

Jupiter Asset Management (Bermuda) Ltd

BERMUDA (REGULATED)(**)

CAYMAN ISLANDS (REGULATED)(**)

MFS Meridian Funds - Contd.

Marshall Wace Asset Management Limited

Masters International Advisors

Montgomery Emerging Markets Fund Ltd

Morgan Stanley Ofis Advisory Mortgage Fd Inc

National Investment Trust Company Ltd

North Atlantic Management Co Ltd

Olympus Capital Management Ltd

Royal Bk of Canada O/S Fd Mgrs Ltd

GUERNSEY (REGULATED)(**)

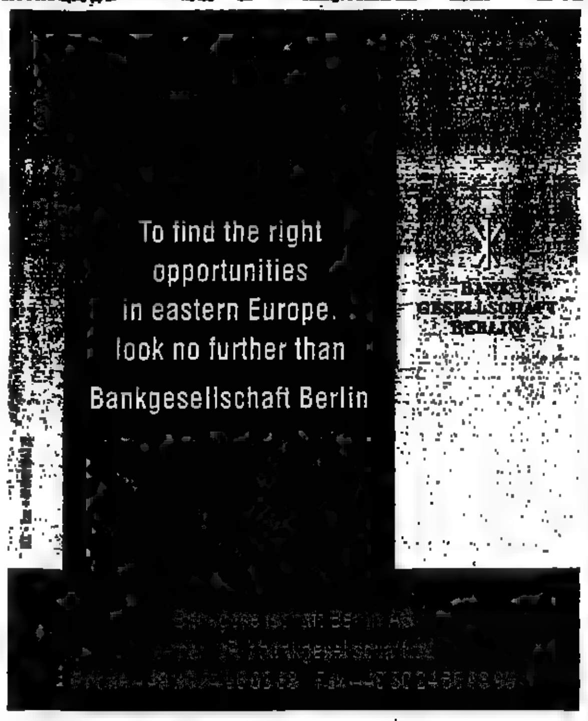
GUERNSEY (FSA RECOGNISED)

IRELAND (FSA RECOGNISED)

AIB Fund Management Ltd

ABN AMRO Global Liquidity Funds Plc

Aberdeen Prolific Intl Fund Plc



ISLE OF MAN (FSA RECOGNISED)

ISLE OF MAN (REGULATED)(**)

JERSEY (FSA RECOGNISED)

IRELAND (REGULATED)(**)

Offshore Funds and Insurances

FT MANAGED FUNDS SERVICE

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Barclays International Funds - Contd.

Gartmore Fund Managers Intl Ltd (z)

HSBC Samuel Fund Mgrs (Jsy) Ltd (1600)F

Lloyds Bank (CI) U/T Mgrs.

Lloyds TSB Fund Managers (CI) Ltd

Midland Bank Fund Managers (Jersey) Ltd

Newton Fund Mgrs (CI) Ltd (1200)F

Murray Johnstone (Jersey) Limited

Newton Fund Managers (CI) Ltd

Northgate Unit Tst. Mngr. (Jersey) Ltd

Royal Bank of Scotland Fund Managers (CI) Ltd

Royal Bk of Scotland Fd Mngrs (Jersey) Ltd

SG Hambros Fund Managers (Jersey) Ltd

Standard Bank Fund Mgmt (Jersey) Ltd

WMB Asset Management (Jersey) Ltd

Worldinvest (Managers) Jersey Ltd

LUXEMBOURG (FSA RECOGNISED)

JERSEY (REGULATED)(**)

Fidelity Funds - Contd.

Fleming Group (b)

Lloyds Bank Luxembourg - Contd.

Schroder International Selection Fd - Contd.

LUXEMBOURG (REGULATED)(**)

OFFSHORE INSURANCES

[illegible]

FT MANAGED FUNDS SERVICE

Offshore Insurances and Other Funds

● FT Cityline Unit Trust Prices are available over the telephone. Call the FT Cityline Help Desk on (+44 171) 873 4378 for more details.

OTHER OFFSHORE FUNDS

LONDON SHARE SERVICE

ALCOHOLIC BEVERAGES

	Notes	Price	+ or -	52 week high	52 week low	Volume '000s	Yld Gr's	P/E
Allied Domecq	N	478½	+7	648	385	3,019	5.3	12.5
Bulmer (HP)		283½	—	380	279½	–	6.6	12.7
Burn Stewart		12½	—	39½	7	38	–	–
Diageo	♣†	678	−18½	*785	476	5,299	2.5	20.5
Glenmorangie A	†	728	+2½	900	625	–	2.5	19.6
B	†	827½	—	980	810	–	1.1	44.9
Highland		245½	−2½	335	225	21	4.7	11.3
5¼pc Cv Sb Bd		96¾	−½	100½	90½	–	5.9	–
Kirin Y		737¼xd	+18¼	894¼	457¾	–	0.8	87.5
Merrydown		27	—	54½	18½	6	–	ф
Seagram C$		228½xd	−1¾	238⅞	214½	–	1.0	–

BANKS, RETAIL

CONSTRUCTION - Continued

	Notes	Price	+ or -	52 week high	52 week low	Volume '000s	Yld Gr's	P/E
SGB Group		195½	—	286	141½	7	4.1	11.0
Swan Hill	†	68	—	94½	32½	0.204	5.9	9.8
Tay Homes	♣	123½	—	142½	105½	–	7.9	8.3
Taylor Woodrow	♣R	169½	—	228	133½	346	3.0	11.1
Tilbury Douglas	♣†	228	+1½	*308	205½	–	6.3	13.3
Try	†	18½	—	29¼	12½	8	6.4	5.8
UKE	♣†	25	—	112½	24½	–	5.0	6.2
Viceroplant	♣	83½	—	88	53½	–	9.5	25.8
Westhomes	♣	116½	—	139½	90½	2	5.2	8.8
Ward Hldgs	♣q	30xd	—	69	25½	332	8.7	–
Westbury	♣†	223½	—	*272½	145	35	4.3	9.1
Wiggins Group	♣	11	—	*16	9¼	152	–	22.3
Wilson (Connolly)	♣†	125	—	191	95½	76	5.6	8.7
Wilson Bowden	†	677½	—	735	485	9	2.9	10.5
Wimpey (G)	♣qv	134	+½	149½	90½	854	5.0	7.4

DISTRIBUTORS

ENGINEERING - Continued

FOOD PRODUCERS - Continued

INVESTMENT TRUSTS

INVESTMENT TRUSTS - Continued

BREWERIES, PUBS & REST

BUILDING MATS. & MERCHANTS

DIVERSIFIED INDUSTRIALS

GAS DISTRIBUTION

HEALTH CARE

INV TRUSTS SPLIT CAPITAL

ENGINEERING - Continued

HEALTH CARE - Continued

ELECTRICITY

ENGINEERING, VEHICLES

HOUSEHOLD GOODS & TEXT

ELECTRONIC & ELECTRICAL EQPT

CHEMICALS

EXTRACTIVE INDUSTRIES

CONSTRUCTION

INSURANCE

ENGINEERING

FOOD PRODUCERS

LONDON SHARE SERVICE

OTHER INVESTMENT TRUSTS

INVESTMENT COMPANIES

LEISURE & HOTELS

LIFE ASSURANCE

MEDIA

MEDIA - Continued

OIL EXPLORATION & PRODUCTION

OIL, INTEGRATED

OTHER FINANCIAL

PAPER, PACKAGING & PRINTING

PHARMACEUTICALS

PROPERTY

PROPERTY - Continued

RETAILERS, FOOD

RETAILERS, GENERAL

SUPPORT SERVICES

SUPPORT SERVICES - Continued

TELECOMMUNICATIONS

TOBACCO

TRANSPORT

TRANSPORT - Continued

WATER

AMERICANS

CANADIANS

SOUTH AFRICANS

TRADED INDEX SECURITIES

AIM

Alternative Investment Market

AIM - Continued

GUIDE TO LONDON SHARE SERVICE

Prices and trading volumes for the London Share Service are delivered by Financial Times Information.

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LONDON STOCK EXCHANGE

US nervousness takes Footsie back from peak

MARKET REPORT
By Peter John

Nobody really expected the London market to remain at its rarefied level, but nor did anyone foresee such a fall.

The FTSE 100 index encountered the initial attack of profit-taking that was almost bound to follow Wednesday's 150-point surge to an all-time closing high.

But then the profit-taking carried on. And then it carried on some more. By the close, Footsie had lost more than two-thirds of its previous rally to end the day down 101.1 at 6,206.5. Nevertheless, it remained above the previous record close of July 1998, a point considered significant, at least by the chart-based bulls.

The disparity between the internationally influenced Footsie and the more domestic junior indices was once again apparent.

The FTSE 250 index, which was still 12.5 per cent below its peak when it opened yesterday, rose 5.9 to 5,226.1. The SmallCap edged forward 2.8 to 2,271.3.

Problems originated, as they often do, in the US. A long-dated bond auction on Wednesday was poorly received and conspired with signs of strong economic growth to send Treasury bond yields to their highest level for six months.

London tried to shrug off the feel-bad factor in the morning and managed to show a net gain after half an hour. Then confidence began to unwind.

Glaxo announced a regulatory problem with one of its products and the positive trend that has pervaded the concentrated results season received a knock after the latest figures from Legal & General.

Hopes of a more settled afternoon session were offset by the latest US data. Durable goods figures showed a 3.9 per cent rise in January as well as being revised upwards for December.

US bonds fell another point and UK gilts followed suit.

Stretched gilt-equity valuations cracked and Footsie was taken back to below 6,200 as the Dow Jones Industrial Average recorded an early fall of around 150 points.

Equities were also undermined after Byron Wien, the strategist at Morgan Stanley Dean Witter, advised investors to cut their US equity weightings from 90 per cent to 85 per cent.

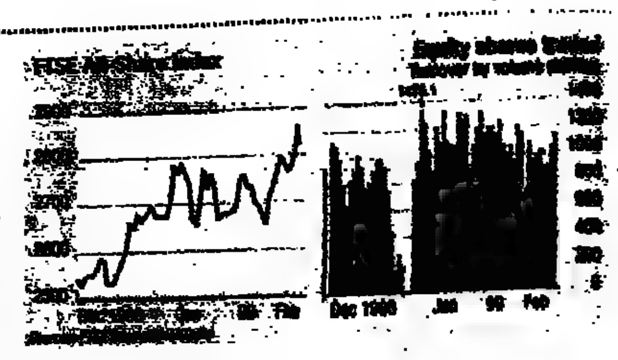
Further pressure came from Asia when Hutchison Whampoa, the Hong Kong conglomerate, placed 50m shares in Orange through Goldman Sachs. In addition, Colt Telecom said it planned to raise £500m via the issue of ordinary shares and convertible notes.

The extra shares flooding, or potentially flooding, onto the market dampened any remaining enthusiasm.

However, David McBain at BT Alex Brown said the sums involved were irrelevant in comparison to the huge amounts of cash being returned to shareholders via buy-backs.

"We are well placed to have a record year for capital returns. It could be up to £20bn this year compared to £11bn last year. Also, cash coming back to the market from takeovers could reach £25bn compared with £27bn last year."

Turnover, which was boosted by the Orange stake sale, remained heavy at 1.14bn shares, with more than 60 per cent represented by Footsie stocks.



Indices and ratios

FTSE 100	6206.5	-101.1
FTSE 250	5226.1	+5.9
FTSE 350	[illegible]	[illegible]
FTSE All-Share	[illegible]	[illegible]
FTSE All-Share yield	[illegible]	[illegible]

Best performing sectors / Worst performing sectors: [illegible]

Orange and Colt tumble

COMPANIES REPORT
By Joel Kibazo and Martin Brice

Telecom issues weighed on the market when a placing was carried out in mobile telephones group Orange, and Colt Telecom announced plans to raise cash.

US investment bank Goldman Sachs took on 50m shares at 851p from Hutchison Whampoa of Hong Kong, the single biggest investor in the UK group, and placed them with a range of institutional investors at 865p. Dealers suggested the investment bank made a turn of around £7m. The sale saw Hutchison reduce its holding from 49.1 per cent to 44.8 per cent but remain the biggest shareholder.

The move cast a shadow over the euphoria that had greeted better-than-expected figures from Orange. Losses were reduced to £98.1m from £139.1m against expectations of about £110m. The shares, having initially risen to 968p, retreated to close 51½ or 5.37 per cent down at 907p.

Early rumours had suggested British Aerospace to be the large seller of Orange. BAe said it had no plans to sell its 5 per cent stake, although it did not see the holding in Orange as core to its operations.

Colt Telecom slipped 131 or 10.26 per cent to £11.45½ after it announced plans to raise £500m in new capital to finance the expansion of its infrastructure including national and international facilities linking its local networks.

News of the fund-raising came as the company announced 1998 results, showing losses had increased to £55.6m from £32.5m a year earlier.

News of a setback for Glaxo Wellcome prompted a wave of selling which saw the pharmaceuticals giant relinquish 82 to £20.66 in trade of 7.4m.

Sentiment was hit by overnight news that Glaxo's flu drug Relenza had failed to clear an advisory panel of the US Food and Drug Administration.

With Glaxo said to account for around 6.4 per cent of the FTSE 100, dealers said the fall in the stock had contributed to the day's reverse in the Footsie.

The FDA panel said Glaxo had failed to prove Relenza's effectiveness.

Mark Tracey at Goldman Sachs said: "This reminds us of the risk profile of the anti-viral franchise but also that some recent product launches have not gone quite as well as hoped at a time when, on some valuation criteria, Glaxo ranks with Pfizer [which is growing much more strongly]."

Mr Tracey believes Glaxo, which has been a strong performer in recent sessions, is *more than fully valued at current levels.*

However a less bearish analyst said: "It is a shock that Relenza has not been cleared but as a new drug it was always going to have a few problems. Let's remember it is only likely to account for about one per cent of group sales in 2002. I think it will be cleared later this year."

In the rest of the sector, vague rumours of a share buy-back from SmithKline Beecham did the rounds in the market yesterday after the company said it is to seek permission from shareholders to repurchase up to 10 per cent of its share capital. Having risen early in the day, the sellers later gained the upper hand leaving the stock to drift 35½ lower to 889p. Turnover was 9.2m.

Demand for Medeva made it the best performing stock in the FTSE 250 after the shares rose 9 or 9.23 per cent to 106½p.

Legal & General suffered a savage markdown amid shareholder disappointment at a fall in profits from new business. The shares, which started last year at 522p, were the worst performers in the Footsie, falling 12 per cent or 109½ to 798p. Volume was 10m.

The stock had "a lot of froth in it at 907½p" according to one analyst. There was disappointment that the embedded value in the company, or net asset value, was shown by the company to be 349p, whereas 370p had been expected by some in the City. At that level, the shares had been trading at 2.6 times book value, while many in its peer group had been standing at about 1.6 or 1.7 times book value.

BAe weighed down

Fears for the future revenue stream from the Al Yamamah contract weighed on British Aerospace, although it announced a strong profit rise before exceptionals. There was also concern over BAe's share of the continuing losses at Airbus Industrie, due to pressure on margins in civil aviation. The shares, which were at 519p in January, were off 21 at 420p. Volume of 11m was among the heaviest in the FTSE 100.

Paul Compton, at Merrill Lynch, said: "Al Yamamah is putting pressure on the business, and although the management is moving to counter this, the outlook is fairly flat."

Related stocks enjoyed a strong day, with BTR Siebe the best Footsie performer. It gained 10 to 265½p following an earlier recommendation from Merrill Lynch.

GKN, also a favourite of the engineering team at the broker, was up 29 at 861p. Merrill has highlighted the likelihood of a soft landing for the UK economy.

Among mid-caps, Glynwed rose 11 to 189p after it sold part of its metals processing division to Tyco International of the US for £145m. Dealers said the move prompted enthusiastic buying *because it shifted the* emphasis of the company's earnings from low technology metals processing.

High volume in the pubs and brewing sector saw J.D. Wetherspoon unchanged at 226½p ahead of next week's results and Old English Pub Company, recovering some of its recent losses, up 15 to 127½p.

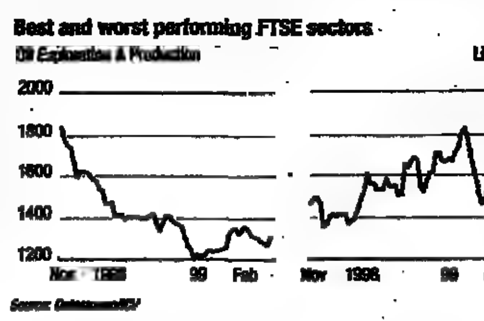
Capita rose 36 to 678½p following a presentation by the company to leading US institutional shareholders, while Warburg Dillon Read was said to have issued a "buy" note that set a price target of 800p on the stock.

Catering group Compass lifted 26½ to 769½p after announcing that trading for the first four months of the current year had been in line with expectations.

Merger talks kept Allied Leisure, up ½ to 28p, and European Leisure, up 1½ to 71½p, steady.

Prospects of a bid fight for software retailer Game saw the shares rise 9 per cent or 12 to 142½p.

Traders said shareholders were unlikely to agree to an offer for the company, which is in bid talks with Electronics Boutique, for much less than last year's 300p flotation price.



FT 30 INDEX

	Feb 25	Feb 24	Feb 23	Feb 22	Feb 19	Yr ago	*High	*Low
FT 30	3771.4	3771.3	3729.8	3687.3	3670.3	3535.1	4004.9	2790.6
Ord. div. yield	2.75	2.78	2.78	2.81	2.82	3.06	4.22	2.72
P/E ratio net	23.05	22.88	22.85	23.88	23.78	23.27	25.41	15.90
P/E ratio nil	22.98	22.78	22.78	23.76	23.66	N/A	28.18	15.71

FT 30 since compilation: high 4004.9 7/10/98; low 49.4 6/26/40. Base Date: 1/7/35.

FT 30 hourly changes

9	10	11	12	13	14	15	16	High	Low
3793.1	3790.2	3787.0	3781.3	3798.7	3785.3	3778.2	3758.3	3807.1	3758.3

STOCK MARKET TRADING DATA

	Feb 25	Feb 24	Feb 23	Feb 22	Feb 19	Yr ago
SEAQ bargains	88,811	88,514	80,993	79,254	85,269	n/a
Equity turnover (£m)†	-	-	3641.8	3014.6	3470.8	n/a
Equity bargains†	-	-	65,578	65,088	64,257	n/a
Shares traded (m)†	-	-	835.9	829.6	851.7	n/a
Total market bargains‡	-	-	78,535	77,948	87,184	-
Total turnover (£m)‡	-	-	4745.0	4709.5	4696.7	-
Total shrs traded (m)‡	1145.5	-	1050.2	1042.3	1065.2	-
Tradepoint turnover (£m)	35.0	41.4	28.7	15.0	28.8	66.9
Tradepoint shrs traded(m)	13.1	13.1	12.2	7.0	9.2	12.7

†Excluding intra-market and overseas turnover but including Crest turnover. *UK only total at 6pm. ‡ UK plus intra-market turnover.

London market data

Rises and falls*		52 Week highs and lows		LIFFE Equity options	
Total Rises	590	Total Highs	67	Total contracts	35,155
Total Falls	774	Total Lows	37	Calls	17,937
Same	1,480			Puts	17,218

Feb 25 *Data based on Equity shares listed on the London Share Service.

FUTURES AND OPTIONS

[illegible]

LONDON RECENT ISSUES: EQUITIES

[illegible]

RIGHTS OFFERS

[illegible]

FTSE GOLD MINES INDEX

[illegible]

FTSE Actuaries Share Indices — The UK Series

Produced in conjunction with the Faculty and Institute of Actuaries

	£ Stlg Feb 25	Day's chge%	Euro index	£ Stlg Feb 24	Year ago	Gross yield%	Net yield%
FTSE 100	6206.5	−1.6	7028.7	6307.6	5764.8	2.87	2.28
FTSE 250	5226.1	+0.1	6018.4	5220.2	5132.9	3.19	2.78
FTSE 250 ex Inv Tr	5247.9	+0.2	6043.1	5237.7	5160.5	3.31	2.90

[illegible]

FTSE Actuaries Industry Sectors

[illegible]

Hourly movements

[illegible]

FTSE INTERNATIONAL

TRADING VOLUME

Major Stocks yesterday

[illegible]

هدية من الأرشيف

Highs & Lows shown on a 52 week basis

WORLD STOCK MARKETS

EUROPE (EMU) Prices in €

AUSTRIA (Feb 25) 1 € = 13.76030 Sch

BELGIUM/LUX (Feb 25) 1 € = 40.33990 Frs.

FINLAND (Feb 25) 1 € = 5.94573 Mka

FRANCE (Feb 25) 1 € = 6.55957 Frs.

GERMANY (Feb 25) 1 € = 1.95583 Dm.

IRELAND (Feb 25) 1 € = 0.78756 Punt

ITALY (Feb 25) 1 € = 1936.27000 Lire

NETHERLANDS (Feb 25) 1 € = 2.20371 Fl.

PORTUGAL (Feb 25) 1 € = 200.48200 Esc.

SPAIN (Feb 25) 1 € = 166.38600 Pta.

EUROPE (NON–EMU)

CZECH REP (Feb 25 / Koruna)

DENMARK (Feb 25 / Kr)

GREECE (Feb 25 / Drachma)

NORWAY (Feb 25 / Kroner)

POLAND (Feb 25 / Zloty)

SWEDEN (Feb 25 / Kronor)

SWITZERLAND (Feb 25 / Frs.)

TURKEY (Feb 25 / Tk Lira)

PACIFIC

JAPAN (Feb 25 / Yen)

HONG KONG (Feb 25 / H.K.$)

INDONESIA (Feb 25 / Rupiah)

MALAYSIA (Feb 25 / MYR)

NEW ZEALAND (Feb 25 / NZ $)

SINGAPORE (Feb 25 / S$)

SOUTH KOREA (Feb 25 / Won)

TAIWAN (Feb 25 / TW $)

THAILAND (Feb 25 / Baht)

AUSTRALIA (Feb 25 / Aust$)

MONTREAL (Feb 25 / Can $)

4 pm close

MEXICO (Feb 25 / Peso)

12.30 pm

AFRICA

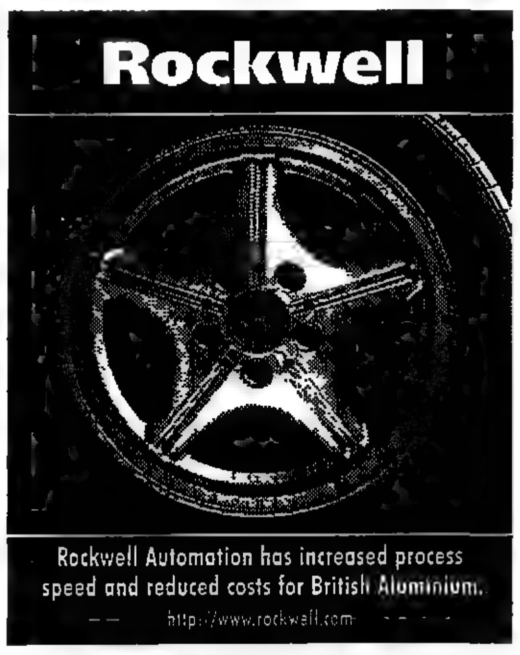
SOUTH AFRICA (Feb 25 / Rand)

AMERICAS

CANADA

TORONTO (Feb 25 / Can $)

4 pm close



FT/S&P ACTUARIES WORLD INDICES

The FT/S&P Actuaries World Indices are owned by FTSE International Limited, Goldman, Sachs & Co. and Standard & Poor's. The Indices are compiled by FTSE International and Standard & Poor's in conjunction with the Faculty of Actuaries and the Institute of Actuaries.

NATIONAL AND REGIONAL MARKETS Figures in parentheses show number of lines of stock	WEDNESDAY FEBRUARY 24 1999 US Dollar Index	Day's Change %	Pound Sterling Index	Yen Index	Euro Index	Local Currency Index	Local % chg on day	Gross Div. Yield	TUESDAY FEBRUARY 23 1999 US Dollar Index	Pound Sterling Index	Yen Index	Euro Index	Local Currency Index	DOLLAR INDEX 52 week High	52 week Low	Year ago (approx)
Australia (75)	212.61	-0.7	197.17	163.80	223.52	223.84	0.4	3.30	214.21	197.09	164.10	224.83	222.95	219.96	163.86	205.45
Austria (21)	182.90	-0.6	169.61	140.91	169.67	169.67	-0.3	1.96	183.98	169.28	140.94	170.24	170.24	253.73	165.27	202.83
Belgium (22)	390.20	-1.3	361.86	300.62	354.41	354.41	-1.1	1.90	395.40	363.80	302.91	358.23	358.23	446.95	279.30	283.00
Brazil (29)	100.95	1.7	93.61	77.77	106.13	372.56	0.0	6.23	99.24	91.31	76.03	104.07	372.65	269.34	89.32	233.30
Canada (113)	201.14	-1.9	186.53	154.96	211.47	218.37	-1.9	1.81	205.07	188.68	157.10	215.05	222.52	248.78	159.94	222.93
Denmark (34)	447.37	-1.3	414.87	344.66	470.33	412.96	-1.1	1.74	453.27	417.05	347.24	475.33	417.43	537.33	420.12	461.75
Finland (25)	615.81	1.3	571.07	474.43	701.56	701.58	1.5	1.61	607.98	559.40	465.77	690.89	690.89	667.25	338.49	346.90
France (74)	321.81	-0.1	298.43	247.93	302.32	302.32	0.2	2.03	322.10	296.36	246.76	301.83	301.83	354.45	253.86	256.97
Germany (55)	262.55	1.2	243.47	202.27	243.73	243.73	1.5	1.36	259.35	238.62	198.68	240.16	240.16	325.61	226.35	240.14
Greece (39)	393.71	7.0	365.11	303.32	413.92	831.26	7.1	1.03	367.77	338.38	281.76	385.68	776.37	429.65	211.47	–
Hong Kong, China (66)	279.99	2.4	259.65	215.71	294.36	278.55	2.4	4.38	273.46	251.61	209.50	286.78	272.04	362.55	196.64	340.79
Indonesia (24)	48.74	1.9	45.20	37.55	51.24	263.49	1.1	1.16	47.84	44.02	36.65	50.17	260.49	64.52	18.04	48.79
Ireland (14)	535.52	0.3	496.61	412.57	542.57	542.57	0.6	1.85	533.89	491.04	408.85	539.38	539.36	605.85	396.15	474.49
Italy (63)	170.56	1.7	158.17	131.41	225.19	225.19	1.9	1.41	167.78	154.37	128.54	220.96	220.96	192.84	128.68	132.82
Japan (445)	96.01	-0.3	89.03	73.97	100.93	73.97	0.3	1.01	96.27	88.58	73.75	100.96	73.75	107.62	76.83	100.43
Mexico (29)	1236.00	0.7	1146.21	952.24	1299.45	13430.03	0.6	1.91	1227.00	1128.58	939.98	1290.73	13348.38	1730.73	787.15	1508.91
Netherlands (26)	490.04	0.2	454.44	377.54	450.01	450.01	0.5	2.11	488.89	449.82	374.53	447.82	447.82	562.73	394.92	447.84
New Zealand (18)	65.09	-2.6	60.36	50.14	68.43	65.05	-1.5	4.33	66.85	61.51	51.21	70.10	66.01	77.84	45.68	75.07
Norway (37)	222.60	-0.7	206.43	171.49	234.02	238.75	-0.5	2.10	224.14	206.23	171.71	235.05	239.95	367.71	181.86	300.66
Philippines (22)	84.49	-1.2	78.36	65.10	88.83	164.43	-1.1	0.99	85.56	78.73	65.55	89.73	160.30	106.08	42.48	89.29
Portugal (16)	244.31	-0.8	226.56	188.22	306.08	306.08	-0.5	1.07	246.26	226.58	188.66	307.75	307.75	[illegible]	194.13	–
Singapore (40)	203.71	0.8	188.91	156.94	214.17	162.12	1.1	1.72	202.09	185.94	154.82	211.93	160.32	246.74	102.45	218.17
South Africa (35)	191.44	0.6	177.54	147.49	201.27	259.22	0.4	3.54	190.29	175.08	145.78	199.55	258.19	346.20	151.55	275.25
Spain (30)	388.73	0.6	360.49	299.49	447.37	447.37	0.9	1.80	386.31	355.44	295.95	443.46	443.46	435.19	290.81	324.72
Sweden (43)	528.13	-0.1	489.75	406.86	555.24	637.37	0.4	1.91	528.75	486.50	405.07	554.49	634.74	628.19	379.18	509.88
Switzerland (30)	398.43	1.1	369.48	306.95	418.88	359.08	1.2	1.19	394.16	362.66	301.96	413.35	354.75	441.65	307.73	378.27
Thailand (31)	21.28	0.3	19.74	16.40	22.38	31.06	0.5	2.90	21.22	19.53	16.26	22.26	30.91	33.84	8.15	31.34
United Kingdom (201)	390.13	1.5	361.79	300.56	410.15	361.79	2.3	2.86	384.28	353.57	294.39	402.98	353.57	401.84	307.96	362.45
USA (613)	517.27	-1.4	479.69	398.51	543.82	517.27	-1.4	1.27	524.39	482.49	401.73	549.92	524.39	527.72	390.12	420.88
Americas (784)	458.47	-1.4	425.16	353.21	482.00	389.26	-1.4	1.31	464.77	427.63	356.05	487.39	394.63	467.90	347.59	381.08
Europe (723)	356.46	0.9	329.66	273.87	373.73	339.39	1.4	2.00	352.17	324.02	269.79	369.31	334.78	386.24	282.63	317.36
Eurobloc (342)	191.27	0.8	83.92	78.02	101.76	101.76	0.8	1.73	100.69	92.65	77.14	100.92	100.92	113.92	81.53	–
Nordic (143)	500.47	0.1	464.11	385.57	526.16	522.62	0.4	1.82	500.24	460.27	383.23	524.60	520.34	555.97	380.04	447.48
Pacific Basin (721)	104.02	-0.1	96.46	80.14	109.36	82.26	0.5	1.56	104.14	95.82	79.78	109.21	81.88	117.89	82.88	110.64
Euro-Pacific (1444)	208.60	0.6	193.44	160.71	219.31	178.86	1.1	1.87	207.27	190.71	158.79	217.36	176.88	221.79	166.00	196.84
North America (726)	495.78	-1.4	459.76	381.96	521.23	496.58	-1.4	1.29	502.71	462.53	385.12	527.18	503.51	506.43	374.92	408.22
Europe Ex. UK (522)	326.85	0.6	303.10	251.81	343.63	318.45	0.9	1.65	324.76	298.81	248.79	340.57	315.63	366.32	260.93	285.79
Europe Ex. Eurobloc (381)	98.57	1.3	91.41	75.94	103.63	101.37	1.9	2.27	97.29	89.51	74.53	102.03	99.44	103.93	77.40	–
Europe Ex. UK Ex. Eurobloc (180)	96.79	0.9	89.76	74.57	101.76	96.91	1.1	1.42	95.97	88.30	73.52	100.64	95.86	109.21	76.16	–
Pacific Ex. Japan (276)	180.03	0.5	166.95	138.70	189.27	184.31	1.1	3.56	179.16	164.84	137.25	187.88	182.31	216.04	128.26	203.38
World Ex. Eurobloc (1921)	105.81	-0.7	98.12	81.51	111.24	105.67	-0.5	1.53	106.54	98.03	81.62	111.73	106.20	106.05	83.08	–
World Ex. US (1650)	207.78	0.5	192.68	160.08	218.45	183.56	1.0	1.90	206.67	190.15	158.33	216.73	181.78	221.91	165.95	200.07
World Ex. UK (2062)	299.62	-0.7	277.85	230.83	315.00	271.98	-0.6	1.43	301.81	277.69	231.21	316.50	273.80	311.48	236.11	262.58
World Ex. Japan (1818)	412.42	-0.5	382.46	317.74	433.59	408.26	-0.3	1.62	414.55	381.43	317.59	434.74	409.72	427.99	320.58	356.29
The World Index (2263)	307.40	-0.5	285.07	236.83	323.18	280.14	-0.3	1.56	308.92	284.24	236.66	323.96	280.96	318.51	242.36	271.03

Emerging markets: IFC investable indices

Dollar terms

Feb 24 Market		Day's chg %	% Chg since 31/12/98
Latin America			
Argentina	736.98	-1.0	-7.6
Brazil	212.56	+1.7	-22.7
Chile	476.98	+1.6	+5.7
Colombia[1]	373.68	-1.4	-14.9
Mexico	520.28	+0.7	+8.0
Peru[2]	136.82	+0.3	+1.8
Venezuela[3]	352.49	-1.2	-22.2
East Asia			
China[4]	22.43	+2.2	-14.3
India[7]	68.96	-0.2	+7.4
Indonesia[6]	22.78	+2.8	-5.9
Korea[5]	45.73	-1.0	-13.7
Malaysia	85.10	-1.9	-3.9
Pakistan[8]	87.70		-7.3
Philippines	115.66	-1.4	-5.9
Sri Lanka[10]	69.77	-1.8	-15.3
Taiwan, China[9]	113.88	+1.0	-1.7
Thailand	56.63		-10.4
Europe			
Czech Rep	38.36	-3.6	-24.4
Greece	704.75	+7.2	+13.8
Hungary[11]	248.02	+3.9	-11.6
Poland[12]	491.51	-2.8	-6.1
Portugal	277.32	-0.7	-5.0
Russia	33.36	+1.6	+42.3
Slovakia	38.43	-2.1	-11.9
Turkey[14]	185.39	+1.1	+26.7
Mideast/Africa			
Egypt	75.79	-0.1	+17.6
Israel	108.87	+0.7	+6.5
Jordan	234.79	-0.3	+8.4
Morocco	168.59	+0.1	+0.6
S Africa[13]	132.45	+0.4	+5.8
Zimbabwe[15]	111.39	+0.6	+5.7
Regions			
Composite	183.94	+1.0	-1.5
Latin America	396.26	+0.8	-5.6
Asia	99.12	+0.2	-7.4
EMEA	121.79	+1.6	+6.6
Europe	160.23	+2.7	+7.0
Easta Europe	57.29	+0.6	-1.4
ME & Africa	56.89	+0.4	+6.1
Comp + Malay	186.34	+0.8	-1.7
Asia + Malay	100.88	-0.3	-5.7

Base date: Dec 1988=100 except those noted which are: (1)Feb 1 1991; (2)Dec 31 1992; (3)Jan 5 1990; (4)Dec 31 1992; (5)Jan 3 1992; (6)Jan 4 1991; (7)Nov 6 1992; (8)Sep 28 1998; (9)Mar 1 1991; (10) Dec 31 1992; (11)Dec 31 1992; (12)Dec 31 1992; (13)Dec 31 1992; (14)Dec 31 1992; (15)Aug 2 1993; (16) July 2 1993.

Latest indices were unavailable for this edition.

4 pm close February 25

NEW YORK STOCK EXCHANGE PRICES

- A -

- B -

- C -

- D -

- E -

- F -

- G -

- H -

- I -

- J -

- K -

- L -

- M -

- N -

- O -

- P - Q -

- R -

- S -

- T -

- U -

- V -

- W -

- X - Y - Z -

Price data supplied by Financial Times Information.

Yearly highs and lows for NYSE reflect the period from Jan 1 1998. Unless otherwise noted, rates of dividend are annual disbursements based on the latest declaration. Volume figures are unofficial.

d-new yearly low. P/E price-earnings ratio. udr- volume. u-new yearly high. x-ex-dividend or ex-rights. yld-yield. z-sales in full. s Dealings suspended.

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GLOBAL EQUITY MARKETS

US INDICES

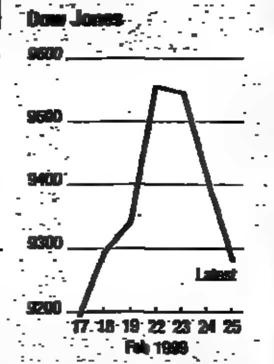
[illegible]

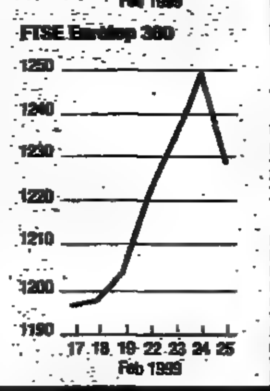
■ RATIOS

	Feb 19	Feb 12	Feb 5	Year ago
Dow Jones Ind. Div. Yield	1.66	1.66	1.65	1.66
	Feb 17	Feb 10	Feb 3	Year ago
S & P Ind. Div. yield	1.18	1.15	1.10	1.40
S & P Ind. P/E ratio	37.72	36.00	36.55	27.24

US DATA

[illegible]





JAPAN

	Feb 25	Feb 24	Feb 23	1998/99 High	1998/99 Low	Since compilation High	Since compilation Low
Nikkei 225	14470.45	14555.45	14508.65	17264.3	12880	38915.9	85.25

Day's high: 14470.45. Day's low: [illegible].

■ TOKYO TRADING ACTIVITY — Volume : 483,418,000

■ ACTIVE STOCKS

Thursday	Stocks traded	Close price	Day's change
[illegible]	15,882,000	53	+5
[illegible]	14,837,000	480	+38
[illegible]	11,480,000	285	+4
[illegible]	9,473,000	289	+19
BTokM	8,857,000	1430	+6
Chyoda	7,238,000	289	+29
[illegible]	7,168,000	982	+25
MitEst	6,017,000	1203	+3
IndBk	5,783,000	580	–5
[illegible]	5,768,000	448	+5

■ BIGGEST MOVERS

Thursday	Close price	Day's change	Day's chge %
Ups			
[illegible]	53	+8	+17.8
Zexel	315	+40	+14.5
[illegible]	901	+86	+10.8
Chyoda	289	+29	+10.7
[illegible]	3100	+280	+9.2
UBE	168	+13	+8.5
[illegible]	215	+16	+8.0
Downs			
Seiyu	382	–23	–5.5

FRANCE

	Feb 25	Feb 24	Feb 23	1998/99 High	1998/99 Low	Since compilation High	Since compilation Low
CAC 40	4152.56	4213.70	4207.95	4388.48	2862.54	4388.48	984.51

Day's high: 4224.90. Day's low: 4146.88.

■ PARIS TRADING ACTIVITY — Volume : 510,408,290

■ ACTIVE STOCKS

Thursday	Stocks traded	Close price	Day's change
FrTele	2,214,029	83.05	–0.45
RhonPA	923,187	42.2	–1.9
ElfAqu	843,347	98.3	+2.25
TotalB	835,233	94.2	+0.3
Axa	788,353	120.4	–3.2
SocGen	764,785	131.1	–3.8
Usinor	719,425	11.51	–0.35
Alcatel	707,622	100	–4.3
Renault	637,002	44.6	–2.2
Casino	586,898	81.2	–1.8

■ BIGGEST MOVERS

Thursday	Close price	Day's change	Day's chge %
Ups			
Moulnx	10.49	+0.62	+6.3
DassSy	38	+1.7	+4.7
NrdEst	25.08	+0.93	+3.9
GalLaf	955	+33	+3.6
Downs			
BIC	50.7	–3.4	–6.3
Renault	44.6	–2.2	–4.7
G'ploys	36.22	–1.67	–4.4
SodxAl	150.1	–6.9	–4.4

GERMANY

	Feb 25	Feb 24	Feb 23	1998/99 High	1998/99 Low	Since compilation High	Since compilation Low
DAX	4958.58	5082.31	4987.58	6171.43	3896.08	6171.43	931.18

Day's high: 5027.78. Day's low: 4932.35.

■ FRANKFURT TRADING ACTIVITY — Volume : 12,448,498

■ ACTIVE STOCKS

Thursday	Stocks traded	Close price	Day's change
Dr Bk	1,119,987	49.05	–1.15
DaimCh	495,579	87.55	–1.75
Bayer	478,353	31.8	–0.95
Leffin	358,380	19.6	–0.23
Commbk	288,886	25.7	–0.1
VW	284,229	60.2	–3.1
H'chst	264,412	42.8	–0.8
Siemens	221,555	68	–1.15
Veba	172,036	48.2	–0.8
RWE	168,041	40.4	–0.2

■ BIGGEST MOVERS

Thursday	Close price	Day's change	Day's chge %
Ups			
BEFFA	77.85	+2.8	+3.7
Fresenius	140	+5	+3.7
Merck	30.8	+1	+3.4
B'sdorf	68.6	+2.1	+3.2
Downs			
AGIndV	19.25	–1	–4.9
VW Pf	35.5	–1.8	–4.9
VW	60.2	–3.1	–4.9
Kiekert	30.4	–1.5	–4.7

UK

	Feb 25	Feb 24	Feb 23	1998/99 High	1998/99 Low	Since compilation High	Since compilation Low
FTSE 100	6208.5	6207.6	6155.2	6307.6	4648.7	6307.6	986.9

Day's high: 6319.8. Day's low: 6193.4

■ LONDON TRADING ACTIVITY — Volume : 1,068,200,000

■ ACTIVE STOCKS

Thursday	Stocks traded	Close price	Day's change
Orange	72,861,150	907	–51½
LucasVarity	38,312,790	284	+1½
BTR Siebe	31,555,250	265¾	+10
ASDA	28,538,430	154	+5¼
Tesco	28,422,450	175	+2¼
Centrica	22,124,170	118	–5
M & S	21,352,080	415	+13½
Br Telecom	17,170,830	1086	–20½
BP Amoco	18,258,050	877	–5
Shell	15,331,880	339	–3½

■ BIGGEST MOVERS

Thursday	Close price	Day's change	Day's chge %
Ups			
Beachcroft	2⅝	+½	+28.6
Hampton Tst	14½	+2	+16.0
Clarke T	145	+18½	+14.6
Cortecs	28	+3½	+14.3
Downs			
French	22½	–5	–18.2
Ranger Oil	180	–30	–14.3
KBC Adv Tch	212	–34½	–14.0
JKX Oil & Gas	7	–1	–12.5

INDEX FUTURES

	Open	Sett price	Change	High	Low	Est. vol.	Open int.
■ S&P 500							
Mar	1253.70	1243.00	–10.30	1258.00	1236.50	115,055	309,882
Jun	1261.00	1255.50	–9.70	1262.30	1238.20	15,061	38,145
■ Nikkei 225							
Mar	14300.0	14510.0	+180.0	14520.0	14360.0	24,262	177,851
Jun	14290.0	14420.0	+130.0	14420.0	14280.0	695	45,528

Open interest figures for previous day

	Open	Sett Price	Change	High	Low	Est. vol.	Open Int.
■ CAC-40							
Feb	4172.0	4212.0	–	4234.0	4151.0	91,808	57,207
Mar	4184.0	4220.0	–	4239.0	4154.0	48,119	125,308
■ DAX							
Mar	5021.0	4908.5	–163.5	5028.0	4905.0	51,808	232,950
Jun	5048.0	4933.0	–164.0	5048.0	4934.5	6,916	90,042

	Open	Sett Price	Change	High	Low	Est. vol.	Open int.
■ DMX							
Feb	734.50	727.75	–18.25	741.00	727.75	39,614	47,053
Mar	733.50	728.00	–16.00	739.25	728.00	36,975	108,667
■ EOREX							
Mar	7188.0	7098.0	–127.0	7225.0	7094.0	25,654	143,250
Jun	7105.0	7037.0	–108.0	7150.0	7044.0	486	4,778

WORLD MARKETS AT A GLANCE

Country	Index	Feb 25	Feb 24	Feb 23	1998/99 High	1998/99 Low	Yield	P/E
[illegible]								
Portugal	BVL 30	4837.80	4880.77	4908.95	6178.80 22/4/98	3589.08 2/10/98	2.08	27
	PSI 20	11159.70	[illegible]	11324.33	14893.00 22/4/98	8114.91 2/10/98		
Russia	RTS	71.35	75.50	73.92	411.61 5/1/98	38.83 5/10/98	na	na

Retreated as investors took fright from failure of investors and government to agree rouble debt swap.

[illegible]

THE NASDAQ-AMEX MARKET GROUP

4 pm close February 25

[illegible]

AMEX

4 pm close February 25

[illegible]

EASDAQ

[illegible]

STOCK MARKETS

Bond yields pull rug from under equities

WORLD OVERVIEW

Equity investors woke up to the recent weakness of the US Treasury bond market yesterday and that induced a burst of profit-taking, *writes Philip Coggan.*

The yield on the 30-year Treasury bond market moved back above 5.5 per cent late on Wednesday as investors worried about the strength of the US economy and the chance that the Federal Reserve would move to increase interest rates.

US shares had reacted badly late on Wednesday to the bond market's move, with the Dow Jones Industrial Average dropping 144 points, and this cast a pall over Asian and European bourses yesterday.

Lower bond yields have been a key pillar of support for the long equity bull market and a rise in yields would leave share prices looking extremely stretched.

Further strong employment data from the US and a 3.9 per cent monthly rise in durable goods orders kept the pressure on Treasury bonds yesterday, with the 30-year yield moving to 5.6 per cent in morning trading, climbing above its 200-day moving average.

In turn, the rise in yields upset the US stock market with the Dow falling nearly 100 by the close in Europe.

Byron Wien, an investment strategist at Morgan Stanley Dean Witter, cut the level of stocks in his model portfolio from 90 to 85 per cent yesterday, switching the proceeds into cash.

Ironically, while the too-rapid pace of US growth was one worry, in Europe investors had cause for concern about stagnation.

A new calculation of the German price index indicated that inflation has dropped to 0.2 per cent year on year in January and February, very close to deflation. And the French INSEE business survey found further weakness in output and export orders.

All this took its toll on European stock markets, despite some broadly healthy results from leading companies such as Man and ABN-Amro. The Dax in Frankfurt dropped 2.8 per cent, the Zurich market fell 1.8 per cent and Paris 1.5 per cent. The London market retreated from Wednesday's all-time high.

Another slant on the global growth picture came from Michel Camdessus, managing director of the International Monetary Fund, who said the worst seemed to be past for Asia and that it was "very clear that Thailand and Korea are emerging from crisis".

The IMF now expects the South Korean economy to grow 2 per cent this year, compared with the 1 per cent fall it forecast as recently as December.

Dow recoils from fears of higher rates

AMERICAS

US stock prices fell steeply in early trading amid fears that higher interest rates are on the way, *writes Tracy Corrigan in New York.*

The Dow Jones Industrial Average fell 138.9 or 1.48 per cent to 9,260.78, while the Standard & Poor's 500 index dropped 1.89 per cent to 1,229.75.

A fall in the US long bond price pushed the 30-year yield up to around 5.6 per cent, its highest level for six months. Analysts said bond market weakness in the light of signs of a strong economy prompted fears of higher interest rates and drove stock prices lower.

Both bonds and equities were unsettled by comments from Alan Greenspan, chairman of the Federal Reserve, earlier this week, which were interpreted as suggesting the Fed's three rate cuts last summer had proved excessive and rates may have to be raised.

Low interest rates have been seen as a crucial support for the highly valued stock market, which has also relied heavily on hopes for strong corporate earnings growth.

Two more US retailers reported quarterly earnings covering the Christmas season yesterday. J.C. Penney, the retailing chain, reported a slide in earnings from its department stores business, though its drugstores helped generate a small earnings increase. The stock fell 2.1 per cent to $37⅞.

The Gap, the fashion chain, fell 3.1 per cent or $1⅞ despite slightly exceeding analysts' estimates. Donald Trott of Brown Brothers Harriman said that although The Gap continued to deserve a premium rating, he felt valuations were too high across the sector given the possibility of higher rates.

Worsening interest rate prospects also hit bank stocks, with Chase Manhattan down 2.05 per cent at $77⅞ and Citigroup down 0.77 per cent at $55⅝. Financial services giant American Express fell 2.36 per cent to $105⅝.

The Nasdaq composite index, which is heavily weighted towards technology stocks, fell 2.06 per cent to 2,291.23. Dell, the computer manufacturer, which has turned down after a strong run, fell a further 2.5 per cent to $80⅝.

TORONTO followed Wall Street lower with worries about interest rate trends following the latest US bond auction sparking heavy selling of bank shares.

Royal Bank of Canada tumbled almost 3 per cent with sentiment also unsettled by weaker-than-expected results. The bank's 1999 earnings per share were C$1.30 whereas the broker consensus was in the region of C$1.23.

The shares fell C$2.15 to C$73.40 in heavy trading volumes and Toronto-Dominion lost C$2 at C$61.30. Canadian Imperial came off 20 cents at C$36.50.

There was some underpinning by selected industrials and metals stocks, but it was not enough to fully cushion the 300 composite index, which by noon was off 76.73 at 6,282.70.

Firmer features included Alcan Aluminium, up 75 cents at C$35.40, and Inco, which added C$1.30 at C$18.80. Conglomerate Canadian Pacific improved 25 cents to C$27.90.

Mexico City edges up despite US weakness

MEXICO CITY reversed initial losses to send the IPC index modestly ahead at midsession. Brushing aside Wall Street's early weakness, the benchmark hardened 14.81 to 4,283.93 in thin turnover. Market heavyweight Telmex put on 10 centavos at 28.65 pesos.

CARACAS ignored the slightly better tone to international oil prices, slipping 45.91 or 1.2 per cent to 3,808.33 on the IBC index at midsession.

SAO PAULO edged lower in early trading and at midsession the Bovespa index was 72 lower at 8,881.

Volumes were minimal with most brokers focusing on the foreign exchanges where the Real, which hit a fresh low against the dollar on Wednesday, rallied modestly as a result of central bank intervention.

Dax falls back through 5,000

EUROPE

Hit hard by deflation scares, FRANKFURT retreated across the board. The Xetra Dax index tumbled back through the 5,000 support level to close off 139.74 or 2.8 per cent at 4,918.55.

The latest inflation figures were far weaker than expected and at 0.2 per cent the lowest rate since pan-German records began in 1991. Combined with a gloomy INSEE business survey from France, it cast a deep cloud over sentiment.

The lack of confidence was reflected in a steep slide for heavyweight DaimlerChrysler which lost €4.60 or 5.1 per cent at €87 in spite of strong results and an upgrade to "accumulate" from "neutral" at Merrill Lynch.

BMW shed €7 at €683 and Volkswagen, which on Wednesday pointed to tough trading this year and which ran into a Merrill Lynch downgrade from "buy" to "neutral", fell a further €3.35 to €59.50.

The FTSE Eurotop 300 index fell 20.81 or 1.66 per cent to 1,229.11. See Euro Prices page.

Insurers were weak. Allianz, which threatened to remove key operations from Germany should the government press ahead with tax reforms, fell €12 to €274.

PARIS put an end to its five-day run, closing 1.5 per cent lower following Wall Street's retreat overnight.

The CAC-40 finished 61.14 off at 4,152.56 as the eagerly awaited February INSEE industrial survey showed a small improvement in production offset by high levels of stocks and price expectations near record lows.

L'Oréal fell €26 to €585 despite in-line 1998 results after analysts said the share was too expensive and Paris-based broker CDC-Bourse cut its rating.

Carmaker Renault dropped 4.7 per cent despite expectations that it would report strong results on Monday. The stock lost €2.20 to €44.60, still suffering from Volkswagen's profit warning earlier this week.

Investors were not amused by BIC's reported 37 per cent fall in 1998 net profits. Shares in the company fell €3.40 or 6.3 per cent to €50.70.

Oil stocks were among the few CAC-40 constituents to post gains, boosted by in-line 1998 results from Elf-Aquitaine, up €2.25 to €98.30. Total rose 30 cents to €94.30.

AMSTERDAM ended in the middle of its day's trading range on the AEX index, closing down 4.33 at 534.51.

DSM attempts to soften a warning of difficult trading at the start of this year with news that it was in talks aimed at a big drugs acquisition within six months came to little. The shares ended €3 lower at €78.40 after a session low of €78.10.

Unilever continued to unwind the gains racked up earlier this week ahead of the announcement of a special dividend. The stock shed 85 cents at €67.45.

Among financials, ABN-Amro eased 30 cents to €18.65 after a relatively upbeat trading statement.

ZURICH was hit by the weaker dollar and the falls in Frankfurt, sending the SMI index down 131.9 or 1.8 per cent to 7,101.8.

Most blue chips were losers, including Nestlé and Novartis, which had led this week's rally. Nestlé gave up SFr51 to SFr2,748 and Novartis was SFr39 lower at SFr2,589.

Swatch Group eased 50 centimes to SFr192 after it announced a 7.5 per cent rise in group net profit for 1998, slightly below most analysts' forecasts. Richemont and Moevenpick announced share buyback schemes. Richemont rose SFr19 to SFr2,245, but Moevenpick lost SFr14 to SFr801.

MILAN followed neighbouring markets lower although some selective buying enlivened an otherwise dull market. The Mibtel index lost 503 or 2.1 per cent to 24,017.

Telecoms stepped out of the spotlight as the market awaited the outcome of a Telecom Italia board meeting yesterday afternoon.

Analysts noted speculation was rife that Telecom planned a merger with its Tim mobile phone business in an effort to fend off the unwelcome attentions of Olivetti. Telecom eased 37 cents to €9.74, Tim gave up 18 cents to €6.27 and Olivetti gave up 20 cents to €2.74.

Fiat turned back from a high of €2.84 to close little changed at €2.71 following newspaper speculation that it was interested in Sweden's Scania truck maker and Japan's Mitsubishi.

Aeroporti di Roma soared 74 cents to €7.60 after the government approved selling off 51.2 per cent through a private placement.

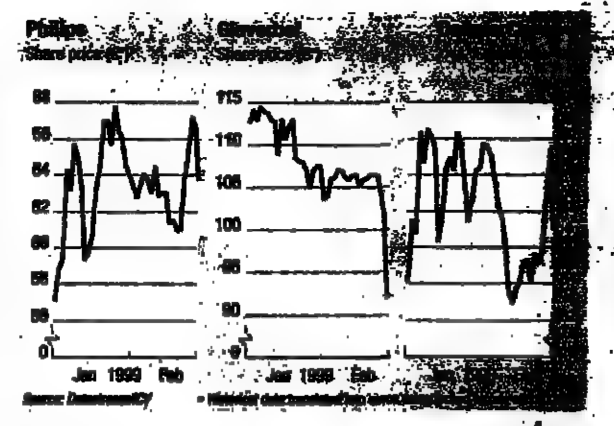
BRUSSELS saw a 9.8 per cent tumble in glass maker Glaverbel in response to disappointing 1998 full-year results that prompted downgrades from several brokers. The shares fell €10 to €92 in a flat market that closed with the Bel-20 index 0.41 lower at 3,404.84.

MADRID tracked the rest of Europe, shedding 1.7 per cent despite individual performances. The general index cut 172.5 to 10,052.1.

Endesa closed 4.4 per cent lower, down €1.10 to €23.82, after narrowly losing a vote in Chile's Enersis where shareholders rejected Endesa's attempt to get a majority stake. Asturiana de Zinc, which reported declining but better-than-expected 1998 profits, bucked the general trend, adding 37 cents higher to €10.22.

STOCKHOLM also fell, with the general index losing 37.17 or 1.1 per cent to 3,353.72. Bucking the trend, Scania added SKr4 to SKr211 after press reports that Fiat had expressed an interest in the truckmaker.

Written and edited by Michael Morgan, Jeffrey Brown, Paul Grogan and Bertrand Benoit



Banks depress Johannesburg

SOUTH AFRICA

Shares in Johannesburg pared early losses thanks to better-than-expected trade data, but still ended lower with the all share index off 1.1 at 5,940.7.

Most of the downside push came from banks with Nedcor, off 260 cents at R126, running into selling in spite of solid results. FirstRand was 20 cents lower at R6.64.

Industrials turned in a more resilient performance, hardening 8.5 to 6,792.9. Golds were 4.9 weaker at 853.

EMERGING MARKET FOCUS

Fraga called in to rescue Real

Arminio Fraga Neto is likely to be confirmed today as Brazil's third central bank president this year by a senate committee in Brasília.

The financial markets as well as the government have great hopes riding on Mr Fraga, picked as the new central bank head at the beginning of this month as the Real collapsed.

The government obviously expects Mr Fraga, with his Wall Street background and six years at Soros Asset Management, to stabilise the markets that torpedoed the Real, the once proud flagship of President Fernando Henrique Cardoso's four-year policy of economic stability.

The markets, accustomed to a firm hand from Brasília, will also welcome an end to a three-week vacuum at the central bank and look forward to clearer signalling from the authorities, particularly over exchange and interest rate policy.

Equity investors have been disoriented because overnight interest rates now stand at a scorching 39 per cent and the Real is fluctuating unpredictably.

On Tuesday, the currency closed below the R$2 to the dollar level for the first time since the peg to the dollar was cut on January 13.

Of course, the central bank's almost complete absence from financial markets has allowed the more audacious investors to frolic in the volatility. Admittedly, the central bank did stir this week to dampen speculation in the exchange markets ahead of today's expiration of dollar contracts on the São Paulo futures market.

After suffering heavily in the wake of the devaluation, Brazilian equities now look remarkably cheap.

Although the Bovespa index has gained 32 per cent this year, in dollar terms prices have dropped 22 per cent. However, most of the action was in January: so far this month, the index has lost 3 per cent in dollar terms.

That is why investors hope Mr Fraga and his team of young professionals will bring a sense of direction to the markets. Not that many expect interest rates to come down quickly, but a reduction in uncertainty would at least allow liquidity to expand and attract more fresh capital from international fund managers – largely absent since the Russian default last August.

Less risk and more cash would be a windfall for the market, but it is probably far too soon to proclaim that Brazilian equities have turned the corner.

The country is still haggling with the International Monetary Fund over new terms for its $41.5bn bail-out and the new deal is only likely to be thrashed out by mid-March.

The country is entering what could be a low point in the cycle with forecasts for a gross domestic product contraction of 4-7 per cent coupled with a burst of 10-30 per cent inflation.

Brazilian companies are generally well run, well capitalised and many are exporters, but most of them will still suffer losses as demand and sales fall and the cost of servicing hard-currency denominated debt rises.

John Barham

Tokyo rises despite profit fears

ASIA PACIFIC

Shares in TOKYO moved ahead during a day which brought a number of profit warnings from Japanese companies, most of them after the market closed, *writes Paul Abrahams.*

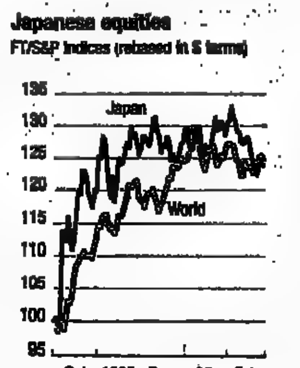
The benchmark Nikkei 225 average rose 0.8 per cent or 115.00 to 14,470.45, the high for the day, after trading as low as 14,363.

The rise, such as it was, was broad-based, with the more representative Nikkei 300 climbing 0.88 or 0.39 per cent to 224.91, while the Topix index of all first-section shares rose 3.84 or 0.34 per cent to 1,124.13.

The momentum was marginally up, with 595 stocks rising, 550 down and 155 unchanged. Volume was moderate with 463m shares traded. In Osaka, the OSE index closed up 10 at 15,289.

Haseko, the troubled construction company, was the busiest stock, gaining Y8 or 17 per cent to Y53 after the group announced it was asking its banks to write off some debt as well as exchange debt for equity.

Shares of the main banks involved fell, with Industrial Bank of Japan down Y5 at Y590, Mitsui Trust down Y4 at Y117 and Daiwa Bank down Y1 at Y184.



Nissan jumped Y26 to Y463 following a report on the Kyodo newswire – later denied by the company – that the group was about to sell a stake as big as 33.4 per cent to DaimlerChrysler.

Zexel, the automotive components group in which Robert Bosch of Germany is taking a majority stake, continued its relentless rise, up Y40 at Y316.

Sakura Bank announced plans to dispose of Y990bn of bad loans and cut 4,200 jobs by March 2003. The moves lifted the shares Y10 to Y260.

Restructuring plans at Ube Industries also helped the stock, which surged Y13 to Y166. However, Daiei, the supermarket group, dropped Y12 or 4.1 per cent to Y280, following its profits warning on Wednesday.

HONG KONG edged lower as worries about interest rates outweighed continued strength in HSBC. The Hang Seng index gave up 19.50 to 9,658.07.

HSBC was the biggest gainer on points for a third day, rising HK$2 to HK$213. The banking giant's shares had gained HK$15 in the previous two sessions after news of a 21 per cent drop in 1998 earnings was sweetened by plans to split the shares, list them on the New York stock exchange and authorise share repurchases.

KUALA LUMPUR dropped 0.7 per cent, recovering from intra-day lows after buyers piled up on Maybank ahead of the company's results.

The composite index shed 3.89 to 549.24 after posting a 3.4 per cent loss before the late bout of buying.

Traders said Maybank, which posted profits below expectations after the close and was expected to set the tone for the corporate results season, could drag the market lower.

JAKARTA shed 1 per cent as profit-taking took its toll ahead of a fresh batch of company results. The composite index was 4.20 lower at 397.80.

Market darling Telkom ended Rp125 off at Rp2,800 after the government suspended the implementation of new tariffs.

SYDNEY moved lower after a dramatic shake-out for biotech stocks on the news that Biota Holdings had failed to win US approval for a flu drug.

Biota shares crashed A$4.75 or 52 per cent to A$4.35 in 8.7m traded after a low of A$3. Elsewhere in the sector, CSL fell 85 cents to A$14.30 and F.H. Faulding 30 cents to A$9.60.

Among blue chips, Brambles gave up 28 cents at A$41.02 in spite of turning in top-of-the-range six-month earnings. Rio Tinto shed 8 cents to A$20.70.

The All Ordinaries index, at a new high earlier this month, ended off 29.7 at 2,904.8.

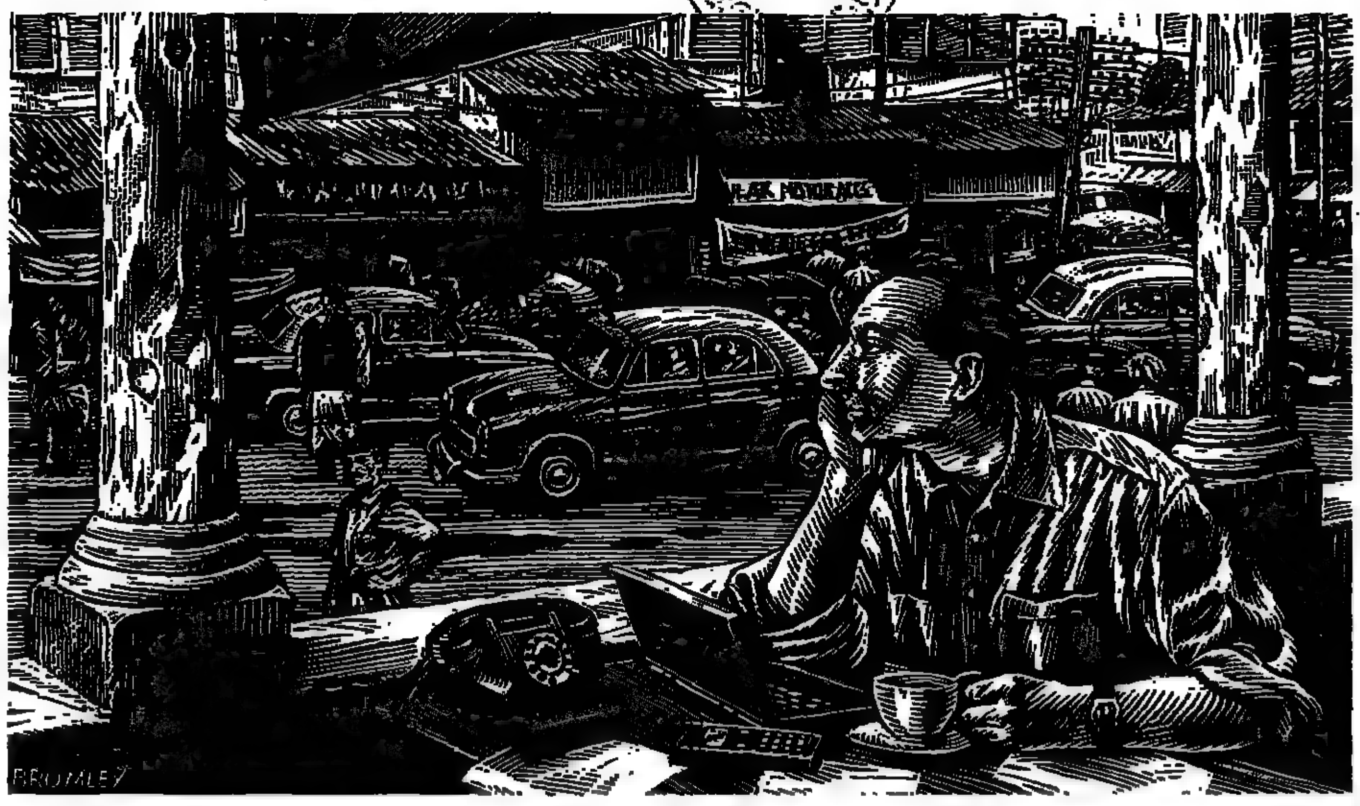
FINANCIAL TIMES SURVEY http://www.FT.com/surveys/

INDIAN INFRASTRUCTURE

FRIDAY FEBRUARY 26 1999

Bumpy ride for foreign investors

Eight years after the gates were opened to private and overseas interests there is a sorry tale of unrealised ambitions, writes Mark Nicholson in New Delhi



India's airports and hotel lobbies *trill, these days, to the sound of* cellphones – there are now more than 1m Indian mobile phone users. In unassuming Indore, business capital of Madhya Pradesh state, a pioneering private landline telephone service is offering the local government operator its first taste of competition.

The $2.8bn Dabhol power project, *cause célèbre* of India's first openings to foreign investment in electricity, is finally pumping megawatts into the grid of Maharashtra state. A privately-funded airport is taking shape in *Cochin. A few private roads and* ports are emerging in some Indian states.

Eight years after India opened its gates to private and foreign investment in infrastructure there is progress. But, given India's gargantuan needs and the high ambitions of successive governments since economic liberalisation began in 1991, progress *has been mixed and modest. If* India's economic growth rate has slowed from above 7 per cent in the mid-1990s to a more sluggish 5 to 5.8 per cent, much of the blame can be attributed to the increasing deadweight of India's ailing infrastructure.

"India is way behind," says the senior official with an international financing institution. "It is really extreme in the poor state of its infrastructure relative to its development."

To cite a few examples, India has not a kilometre of world-standard motorway to its name: the number of telephones per person, at 2 per 100, is among the lowest in the developing world; power shortages lag demand by an average 8 to 9 per cent, the gap reaching 18 per cent at peak times.

For foreign investors, initially excited by the apparent prospects implicit in such deficiencies, however, the past eight years' journey has often been as crawling and bumpy as an Ambassador car ride over a potholed Indian road.

In critical sectors such as power and telecoms, ambitious *policies* to attract private investment have often foundered on policy revision and review, bureaucratic delay, political controversy and other, often unforeseen, costs and complexities.

Foreign investors, too, have often proved over-optimistic. A gaggle of foreign independent power developers rushed to sign memorandums of understanding *(MOUs)* with state governments in the early 1990s, only to find their projects bedevilled with bureaucratic impediments and often hobbled by the inability of insolvent state governments, the main power purchasers, to pay. Dabhol, developed by Enron, the US energy group, is one of just 18 private power projects commissioned in the last five years, disappointing fruit of more than 70 MOUs.

Local and international telecoms companies bid high for licences to provide cellular and basic telephone services during a sweeping 1994 government auction, only to find they had mostly overestimated demand, underestimated costs, and failed to reckon with emerging regulatory difficulties.

In all, says a senior World Bank official, the past eight years have proved an arduous learning process both for government and investor. "There was an assumption on the part of government that private investors could simply enter without there being any real cost," he says. "This proved wrong. But the fault has been at both ends – a lot of developers came in without caring how they got paid. Mistakes have been learned, but the lesson is that there are no easy answers."

The result has been that the curve of foreign direct investment into infrastructure, a sector earmarked unequivocally as a priority by the four governments since 1991 and without qualm by the otherwise economic nationalist Bharatiya Janata party, which heads the current coalition, has stayed flat when it should be soaring.

A definitive government report on India's total infrastructure financing requirements estimated in 1996 that India needed up to $130bn sunk into power, ports, roads, telecoms and urban infrastructure between then and 2001. It reckoned another $215bn would be needed in the five following years. But India's total foreign direct investment, for all sectors, is likely just to exceed $3bn this year, roughly the same level as last.

This low level can perhaps in part be *attributed to investor* aversion over the past two globally turbulent years. It is certainly not for want of government attention. Rakesh Mohan, who chaired the 1996 India Infrastructure Report, says there has generally been a continuity of effort by the four governments since 1991 towards infrastructure policy and that most of his report's recommendations on inducements and structural reforms to attract investment have been taken.

New fiscal incentives have been offered for almost all infrastructure sectors. A partly state-backed Infrastructure Development Finance Corporation has been established to provide the *catalyst* for private infrastructure funding. Regulatory authorities have been created for telecommunications, main ports and power, the last both at the national level and within an increasing number of Indian states. "There has been broad progress, really, on all fronts," says Mr Mohan.

Yet investment remains slow. *The reasons differ by sector*, although there are common factors. There is the general problem of India's cumbersome bureaucratic procedure, particularly acute for power developers which have to win innumerable project "approvals" from both central and state governments. Enron reckons its project required no fewer than 347 separate *such* "approvals", quite apart from the political problems its Dabhol project – India's biggest foreign investment – faced in being cancelled, then revived, by the Maharashtra state government. That episode, too, sullied investor confidence in India.

Government inexperience in dealing with private sector entry *into a previous public sector* monopoly, at both central and state level, has also held up investment. The hard lesson, says Montek Singh Ahluwalia, former finance secretary and senior bureaucrat with India's planning commission, has been that "the entry of the private sector into a regulated monopoly is simply not the same as allowing *people to come in and build* cars". In sectors such as ports, power and telecoms, the government has had to either create or radically overhaul regulatory systems, for example. It has also had to find new ways of forcing inefficient, and often reluctant, state entities into commercially viable contracts with private partners.

But perhaps the most vital lesson of India's faltering attempts to renovate and expand its appalling infrastructure is that however much private investment can be attracted there will finally be no substitute for massively increased public sector investment. Mr Singh estimates that private sector investment can never account for more than 30, or at the limits 40, per cent, of overall infrastructure investment.

As things stand, however, with India's fiscal deficit stubbornly high at around 6 per cent of GDP, this means there is also no substitute for making existing infrastructure services pay their way and raise their own resources. This means cutting subsidies and allowing new regulatory authorities to set remunerative tariffs, *free of political controls.*

As Mr Mohan points out, where user charges are economically viable, the results can already be seen to be dramatic. India's state telecoms provider, for example, has increased the country's "teledensity" from below 1 connection per 100 people in 1990 to 2 per 100, an expansion almost entirely financed by internal resources. "Telecoms is the one area of infrastructure where the charges are not being subsidised," he says.

But while remunerative charges may be politically sustainable in India for telephones – still a luxury in a country where 36 per cent of the population lives below the poverty line – this is not yet so for supplies of power or water, perhaps the country's two most *critical needs.* Subsidised electricity, especially for farmers and domestic consumers, as well as virtually free water supplies, are still widely regarded among Indians, and certainly most politicians, as a right.

This view may slowly be changing, however, at least with regard to power. The basic impediment to investment in the *power sector is the insolvency of* almost all 20 of India's state electricity boards, whose utilities provide 80 per cent of the country's power. Neither can these boards, the combined losses of which amount to 1.4 per cent of GDP, afford to pay for private power, nor to invest in fresh capacity themselves. Nor will they ever, while politically-controlled *state utilities continue to* offer subsidies to favoured "vote

Continued on Page 2

POWER: Overview by Mark Nicholson

Fast-track is stuck in the sidings

Developers and governments have learned some harsh lessons on the road to private investment in the electricity industry

Nowhere has the learning curve proved sharper, either for the Indian government or for the legion developers who descended on Delhi in the early 1990s, than in the attempts to draw foreign and private investment into power.

Out of dire need in 1992 the Indian government for the first time encouraged private developers, local and foreign, to invest in power generation. With state electricity boards largely broke and national coffers squeezed by the attempt to rein in the fiscal deficit, the government saw no choice but to pull private capital into the effort to close the country's gaping power gap.

India's power shortages were growing increasingly grave. Demand for power outpaced demand by 8 per cent on average and by 18 per cent in peak hours, and the gap was widening. The government's eighth five-year-plan for 1992-97 had estimated that public, and some private, investment would add 30,538MW of new capacity over the period. In the event, the public purse could afford just 16,742MW.

What India needed, according to the authoritative India Infrastructure Report of 1996, was at least 53,625MW of new capacity by 2006. Along with modernisation, that came to an estimated investment bill of Rs6,000bn, and would result in capacity nearly double the 89,166MW.

The government focus at first was almost exclusively on creating fresh generating capacity. To pump prime investor interest a series of fast-track power projects, most with foreign developers, were accorded counter guarantees – essentially sovereign guarantees for payment on behalf of the insolvent state electricity boards.

From the outset the fast-track projects belied their name. Most found themselves quickly mired in complex negotiations, both with state and central governments over their power purchase agreements and a raft of other official clearances.

An overriding problem, as Delhi acknowledged from the outset by offering the sovereign guarantees, has been the inability of the state electricity boards to pay, either for themselves or someone else's generated power. These degenerating utilities provide 80 per cent of India's power yet incur losses worth 1.4 per cent of GDP.

Urged by the World Bank, and later the Asian Development Bank, a small coterie of reform-minded states began to face the inevitable and, tempted by considerable direct lending from each, began to undertake comprehensive overhauls of their utilities. Leading the trail was Orissa (*see Case Study on this page*), the poor eastern state, which won almost $1bn of loans, underpinned by the World Bank.

Other states have followed, or are following. Delhi, for its part, has passed laws allowing private investment in distribution, whilst creating a national power regulator and the guidelines for state regulatory commissions.

Focus has shifted, then, from simply encouraging investors to build power stations to encouraging the states to reform and towards the problems of distribution. Transmission and distribution losses in India are twice the global average of 10 per cent and, in places like Delhi, 40 per cent. Much of it is theft (*see facing page*).

But reform of the state utilities will take years before it provides a viable platform for serious investment. Even with such reform, there is still need for new capacity. Hence the government's latest bid to attract foreign investors and to overcome the chronic illiquidity of the state utilities.

The BJP-led government is inviting bids to put up 7,000MW or more of new capacity, chiefly targetting global power companies not yet tempted by India.

Tendering gets under way this month.

STATE FINANCING OF POWER by Mark Nicholson

Surging to a string of successes

PFC's no-nonsense approach to reforms is getting through to the state governments and their lossmaking utilities

The last thing you might expect of any institution whose main clients are India's chronically loss-making state electricity boards (SEBs) is a buoyant balance sheet, soaring profits, highly respectable debt rating, and a solid track record in international capital markets.

Power Finance Corporation (PFC), the state-owned development finance institution for the power sector, nevertheless boasts all these. Last year's after-tax profits of Rs5.3bn were a healthy 120 per cent up on the previous year, showing a return on net worth of 22 per cent, up from 12 per cent a year earlier.

Enjoying sovereign ratings from both Moody's and Standard & Poor's credit rating agencies, PFC last year managed to raise a $100m syndicated loan on international markets, at a competitive 1.15 per cent over Libor and just two months after India's nuclear tests and the imposition of economic sanctions.

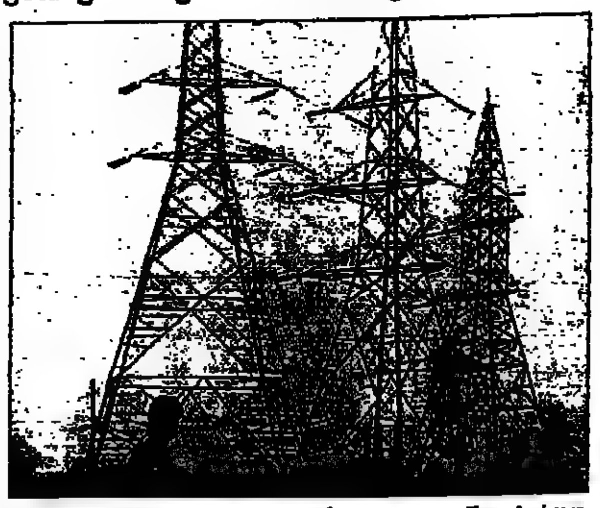
The institution, which draws its funds from local and international borrowing along with support from the international development institutions, plans this year to raise around $250m more from overseas markets, either through a bond issue or syndicated lending.

The record is the more remarkable given that PFC's chief borrowers are India's SEBs, the politically-controlled state utilities which are mostly insolvent as a result of charging uneconomic tariffs to politically-favoured constituencies, notably farmers and household consumers.

Combined losses of India's 20 SEBs reached $2.3bn in 1996-97, the latest figures available, not counting a further $3bn in unpaid dues to other state and central government entities.

Nevertheless, by last year, PFC's repayment record from these horribly loss-making concerns was almost 100 per cent, according to Uddesh Kohli, PFC's chairman and managing director. Moreover, in the past three years PFC has whittled down to almost zero a total of Rs5bn in unpaid outstandings from the SEBs.

In part this reflects the fact that as the main government lender to the state boards, PFC enjoys a politically-privileged place among the SEBs' lenders. In part, also, Mr Kohli suggests it reflects PFC's attempts to ease the terms of loans to suit the struggling state boards, virtually none of which operate at a profit.



Electricity board losses now exceed $2bn — Tony Andrews

But it also appears to reflect a gathering sense among India's state governments, and the state utilities they control, of the need to undertake wholesale reforms of their operations, and of the role of institutions like the PFC in helping finance such moves.

"We don't just give them money, we say 'you also have to improve your operations'," says Mr Kohli. "And the awareness is there now. There's quite a change of understanding among the states that power is needed for development, and that this in turn means they must raise tariffs and reform, set up regulatory commissions, and so on. A lot of them feel now there is no alternative to major reforms."

As India's state governments slowly embark on the path of reform, the PFC is playing an increasingly critical role as the country's chief domestic source of financing for such moves. Total loan disbursements, for example, have risen from Rs7.8bn in 1994-95 to Rs20bn last year. Mr Kohli says he expects the total to reach Rs25bn for the fiscal year ending in March 2000.

In most cases PFC is insisting that recipient state governments undertake some of the basic moves to staunch the losses from their utilities and place them on an economic footing. This includes moves to "unbundle" utilities which in most cases are responsible for generation, transmission and distribution, separating such functions with an eventual eye to privatisation. PFC is also insisting the states establish independent regulatory commissions to ensure the setting of commercial tariffs.

The PFC has also placed a particular emphasis on encouraging state utilities to improve efficiency rather than simply financing additional generating capacity. Mr Kohli reckons that around half of total lending is devoted to improving transmission and distribution systems and less than half as component financing in new generating projects.

He says that financing currently in place and devoted to improving the lamentable transmission and distribution losses of Indian utilities (which average more than 20 per cent – or twice the international norm) will bring up to 5bn kilowatt hours of power back into the system over the next three years.

But with new lending – and PFC is in discussions with 12 Indian states regarding reform packages – Mr Kohli insists PFC is not insisting on the imposition of any set pattern or model of reform. "We're not insisting on the World Bank model nor the Asian Development Bank model, not insisting they unbundle or corporatise this or that element of the utility. We are saying, ultimately, what matters is the result, not the path to it."

Thus the PFC is sharing, along with the World Bank and ADB which pioneered the moves towards financing state-level power sector reform, a division of labour in encouraging the slow, but apparently sure, process of state reforms. The bank began the trend with the radical overhaul of Orissa state's utility, following up with similar lending to Andhra Pradesh and Haryana states.

The ADB, in a tacit understanding with the bank, has focused on Gujarat and Madhya Pradesh states. The PFC, meanwhile, is discussing reform with many of the other states, notably West Bengal, Assam and Punjab. By the end of 1999, the PFC hopes to have loans supporting reform packages in place for each of these three states.

CASE STUDY
ORISSA

Will to reform proves to be not enough on its own

Orissa was the first Indian state to muster the political courage to break the federal government's monopoly over the power sector. But, four years down the road to reforms, the state has run into some some blocks.

In August 1998 the chief minister announced that the state government would "disinvest 49 per cent in Orissa Hydro Power Corporation (OHPC) in the near future" in favour of a strategic private sector partner. An empowered committee was formed to oversee disinvestment but, as it was about to appoint merchant bankers, the scheme was surprisingly "shelved for the time being".

The postponement has caused dismay among private power producers who want to own 49 per cent of OHPC. The utility's five hydel power stations have an aggregate capacity of 1,272MW, and OHPC is now investing Rs11.25bn in two new hydel projects with capacity of 606MW.

Harishankar Sahu, managing director of OHPC, says: "We are making profits of Rs800m a year and these will rise as new capacity is commissioned. Our company is considered a goldmine. Disinvestment will usher in a new management and culture, leading to better efficiency."

More disappointing for the government is the lukewarm response to the attempt by Gridco, the state-owned power transmission and distribution company, to privatise the distribution business.

Gridco prepared the ground for privatisation by dividing the state into four zones – north, south, west, and central – and creating a distribution company for each zone. Gridco's plan is to sell 51 per cent of each distribution company to a strategic investor by the end of March.

Initially, about a dozen companies – including EDF of France, Eskom of South Africa and Enron of the US – were understood to be interested, but bids were received only from three parties, with none for the Central zone.

Officials at the Orissa Electricity Regulatory Commission (OERC) say some foreign companies cried off as they viewed the state's power distribution business as being too small for them. Industry officials, however, say the unusually high level of technical and non-technical loss of electricity in Orissa and the long time it would take to set the system in order were the real sticking points.

The loss of power during transmission and distribution (T&D) in Orissa reached 48.4 per cent in 1996. SC Mahalik, chairman of OERC, describes the situation as "disturbing". He says: "I want the T&D loss to be brought down to 35 per cent in the next two years. The power tariff can be frozen at the present level, giving the utilities a reasonable rate of return, if the T&D loss is pegged at 25 per cent."

Mr Mahalik says the T&D loss in Orissa is representative of the malaise to be seen in most parts of the country. "This is because of the skewed investment in the power sector," he says.

"Most of the investment is directed at building power generation capacity. The T&D system is either inadequate or totally run-down, leading to poor evacuation of electricity from generation centres."

Orissa has received a $350m line of credit from the World Bank and another $78m from the UK's department for international development to strengthen the T&D system and fund a "revenue improvement action programme".

Mr Mahalik says: "Along with reinforcing the T&D infrastructure, what Orissa needs is new management techniques and the political will to curb large-scale power theft."

More successful has been the sale of 49 per cent of Orissa Power Generation Corporation (OPGC), the state-owned thermal power producer, to AES of the US. "Signs of improvement in working are already there. AES has a big stake in Orissa. It is independently building two coal-fired power plants at Ib Valley. A separate joint venture between AES and OPGC will put up another two power units in the same region."

Orissa needs to give another big push to reforms to make the power sector viable. The OERC's Mr Mahalik says that where Orissa has succeeded is in encouraging other states to explore the possibility of unbundling the government-owned electricity boards into separate generation, transmission and distribution companies. "Progressive tariff rationalisation and reduction of cross-subsidies demand the constitution of an independent regulator on the lines of Orissa," he says.

Andhra Pradesh, the southern Indian state, is adopting the Orissa model of power sector reforms, to be supported by a World Bank $1bn line of credit.

Kunal Bose

CASE STUDY
CAPTIVE POWER

Rolls-Royce sees some opportunities

Once upon a time there was a natural link between rises in India's industrial production and increases in power output. No longer: economists now say there has been such a rise in the number of companies choosing to establish their own dedicated power units, or captive power, that the correlation has been broken.

There are no wholly accurate measures of the amount of captive power generated in India – the Tata Energy Research Institute reckons such small units, mostly diesel generators, added up to 11,013 megawatts of installed capacity in 1994-95, its latest estimate. That represents fully 12.5 per cent of the country's publicly-available installed capacity.

According to Rolls-Royce, the UK engineering group, it also represents a promising market opportunity. By summer, the company will have set up a "diesel cell" in India, probably in a joint venture with an Indian engineering company, to supply diesel power units for companies determined to bypass irregular and costly publicly-available power.

Rolls-Royce, already well established in India producing jet engines with Hindustan Aeronautics in Bangalore and as the main supplier of pumping engines to the oil and gas sector, believes the captive power sector will grow to capacity of around 1500MW within the next four to five years. By then, the company hopes to be installing around 175MW a year of captive power units.

The move is an assault on a market so far dominated by Wartsila, the Finnish-based engineering group, which currently holds an estimated 65 per cent share of India's captive power market. The company installed a total of around 220MW of privately-generated electricity last year.

According to Robin Etherington, head of industrial business for Rolls-Royce in Delhi, the Indian market offers immediate prospects for sales of around 60 diesel-based power units a year, imported from the company's Bedford factory in the UK and each worth roughly $1.6m when ancillary components are added in The company initially is focusing on selling its 5000 series diesel engines, which generate ½MW per cylinder and can be configured up to 20 cylinders.

The market will be small or medium sized enterprises which can better bear the costs of establishing their own dedicated power than those of interrupted and erratic supplies from their local state electricity boards. A four-engine Rolls-Royce unit, for example, could provide enough power, at 24MW, for a 110m-tonnes-a-year caustic soda plant or a 100,000-spindle textiles mill.

Moreover, Rolls-Royce claims the average cost of power from such units over their expected 15-year life would be highly competitive. Given the heavy cross-subsidies implicit in most industrial power tariffs from state electricity boards, which overcharge industry to subsidise farmers and domestic users, India's average industrial power tariff is Rs2.63. Rolls-Royce claims its units would offer rates of between Rs2.50 and Rs3 per kilowatt hour.

Industrial power tariffs are likely to remain high for some years, with state governments probably only slowly addressing the political difficulties of charging farmers and home consumers viable tariffs. Moreover, additional generating capacity from state and central power utilities is likely only gradually to catch up India's growing power demand. Which, for Rolls-Royce, suggests further opportunities for its captive power unit in India, the company's first such venture.

In the next 18 months to two years, suggests Mr Etherington, Rolls-Royce will look at introducing gas turbine engines for captive users, including its 52MW Trent jet engine, a power-generating version of its aero engine. One of those, he says, would be quite enough to power a small industrial park.

Mark Nicholson

Bumpy ride

Continued from Page 1

banks" such as farmers. Average power tariffs in India are just 80 per cent of costs.

All manner of devices and instruments have been tried by India's government to circumvent this fundamental problem, including state finance guarantees or "escrow" financing for power projects.

But there is now acceptance among central policy-makers, and gradually among state politicians, that the sole solution is to allow independent regulators in each state to set commercially viable tariffs while undertaking wholesale structural reforms of state utilities.

The World Bank and the Asian Development Bank, along with India's state Power Finance Corporation, are now making power-related lending to states only which undertake reforms aimed at improving their utilities' revenues (*see State financing of power, this page*). In Orissa, Haryana, Andhra Pradesh, Gujarat and Madhya Pradesh states, the Bank and ADB are underwriting wholesale structural reforms of the state power boards. World Bank and ADB officials say they are cautiously optimistic that a trend has been set.

Moreover, there is evidence that even India's farmers will be willing to pay more for power if it means they get reliable supplies. A "nursery" scheme in Rajasthan state, for example, under which farmers can jump long queues for power connections by paying five times the connection charges and then thrice the normal power tariff, has signed up 60,000 farmers in a year.

Optimists draw cautious hope. "Things are beginning to happen with regard to user charges," says S.L Rao, the economist recently appointed as the inaugural chairman of the Central Electricity Regulatory Authority. "But it's gradual, there's no overnight transformation."

THEFT OF POWER by Shiraz Sidhva in New Delhi

Mission impossible – tracking pilferers

Electricity supplies are notoriously erratic; cheating consumers, not just from the poor classes, simply make the situation worse

Debasis Bagchi is a detective with a difference. Operating out of the warren of drab offices at Delhi's state electricity board in south Delhi, he painstakingly plans raids on the city's residential and industrial areas, to apprehend power thieves.

As inspector-general, vigilance, of the Delhi Vidyut (electricity) Board (DVB), he has the unenviable task of detecting and minimising electricity theft in Delhi.

The problem is chronic and widespread. If Delhi's citizens can find a way to steal power, they will. The culprits include businessmen and petty shopkeepers, the landlords with palatial bungalows in Delhi's posh enclaves, and the poorest shanty-dwellers in the capital's wretched slums.

Theft and pilferage account for half of the capital's alarmingly high transmission and distribution losses – at 4 per cent these losses are almost double the national average of 2 per cent and considerably higher than the international average.

Returning home one recent Sunday evening after raiding a middle-class residential colony in west Delhi, Mr Bagchi admits dejectedly that his is an impossible mission. He is prepared to work 14-hour days and sacrifice his weekends, but he knows he is barely scratching the surface of this endemic social problem. His enforcement team of 100, of which only 30 are senior officers, is ill-equipped to take on a city of nearly 14m people who have no compunctions about cheating the system, evading taxes, or shirking social responsibility.

Delhi's ailing electricity board collects dues for only 40 per cent of the power it distributes. Official figures show losses of Rs12bn a year due to faulty transmission and theft, but a private study done last year by Intra Eff., a Geneva-based company specialising in technologies to reduce power losses, estimates DVB's commercial losses are much higher, perhaps Rs20bn.

Delhi's citizens love to complain about the inefficiencies of their electricity supplier, and with good reason. The lossmaking utility, like many others in the country, is notorious for its erratic power supply. Consumers suffer longer hours of power cuts during each scorching summer. But they only make matters worse by using larger loads than have been sanctioned and paid for, by tampering with electricity meters – or bypassing them by hooking on directly to an electric pole – or just refusing to settle their bills.

Delhi teeters on the brink of a power crisis. The central government's ministry of power has assessed that there will be a shortfall of nearly 1,000MW by the summer, with peak demand estimated at 2,700MW. The city's outdated transmission and distribution network produces 300MW, and can import only up to 1,400MW of power from neighbouring states. The quality of power is also unsatisfactory, with the network invariably tripping with the burden of illegal loads, and blackouts that could last for days.

Two months ago the power minister, P.R. Kumaramangalam, warned Sheila Dixit, Delhi's chief minister, that the capital would face a "severe power crisis" unless "drastic remedial measures" were taken.

Virendra Singh, DVB's chairman, blames the city's unbridled and unplanned growth, and its growing population. A consumer boom since 1991, which has made air conditioning more common, and the mushrooming of small businesses in residential areas, have exacerbated the shortages.

A big obstacle in DVB's war against theft is that some of its staff is involved with dishonest consumers. "Without their help consumers could not cheat us with such impunity," says Mr Bagchi. There are widespread complaints about DVB linesmen demanding bribes or threatening to cut off electricity. "We are trying our best to stem the rot within," he says.

The former intelligence officer has met with some success. Since he took over in May 1998, the number of raids has risen from 14,010 in 1997-98 to 17,529 for the first 10 months of the current financial year. The total number of thefts detected has increased marginally, from 5,884 to 6,316 cases, but the value of the thefts detected has risen this year, to Rs523.8mn for 76,129MW stolen from Rs320.4m for 46.46MW last year.

Mr Bagchi has little time for the common perception that slums and unauthorised dwellings account for most thefts. "On the contrary, the real defaulters are the big businessmen, and we have to catch them and lock them up," he says. Small factories and Delhi's export houses thrive on stolen electricity and think nothing of digging up underground cables to gain an illicit supply.

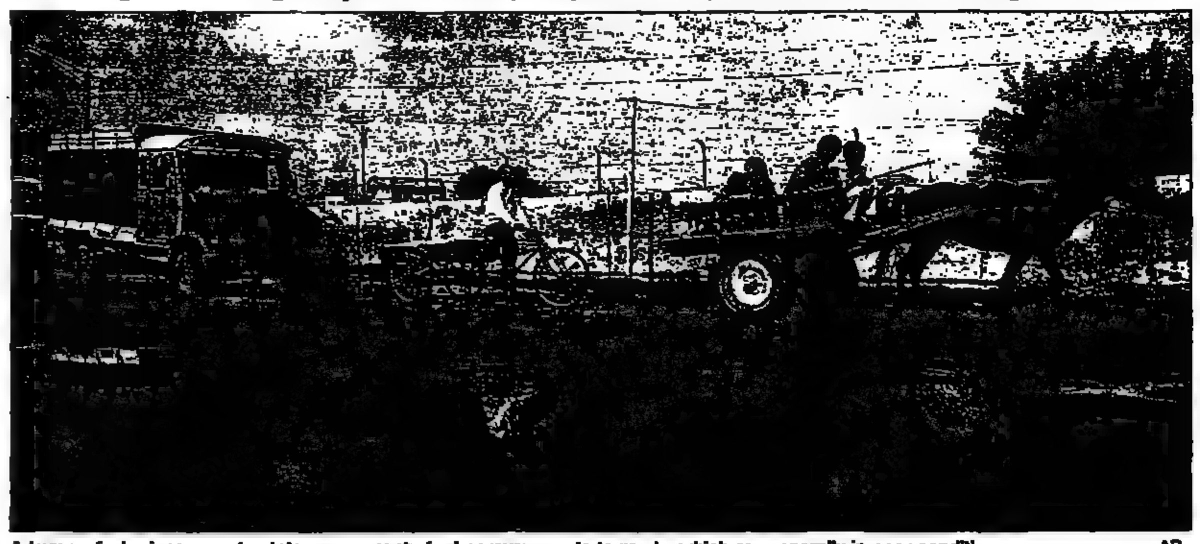
"The richer the colonies, the more they steal," says Ram Singh, a former DVB linesman who admits that he often succumbed to the temptation of tampering with meters for a bribe before he retired last year.

"The only way we can stop this is by enlisting the help of local organisations and individuals and changing people's attitudes," says Mr Bagchi. For now, Delhi residents would rather enjoy free electricity than pay for an uninterrupted supply.

ROADS by Shiraz Sidhva

Travelling without a ticket

Chronically choked – and dangerous – highways face little prospect of improvement until funding is found



A levy on fuel prices goes to state governments for improvements to roads, which are generally in poor condition AP

Prime Minister Atal Behari Vajpayee has a dream for India. It fits in well with his party's nationalistic agenda, strengthening the links between the diverse states that make up one great united nation. He plans to connect the four corners of the Indian sub-continent with 7,000 kilometres of six-lane highways and expressways by 2010.

The Rs280bn project is part of the ambitious National Highways Development Policy announced by Mr Vajpayee last October. It envisages a north-south corridor linking Kashmir in the north to Kanyakumari in the south, and an east-west corridor from Saurashtra in the west to Silchar in the east. It also incorporates a network of 6,000 kilometres of four-lane highways linking the main cities of Delhi, Bombay, Madras and Calcutta.

The highways project is a blueprint for growth, but two looming roadblocks – a lack of funding, and the absence of a legal and technical framework to ensure speedy implementation of the project – threaten to bring it to a standstill.

"The government has to figure out how to increase resources, first and foremost," says Anil Bhandari, the World Bank's transport specialist in New Delhi. The central minister of surface transport, M. Thambidurai, has announced that by 2020 a network of 13,500 kilometres would be completed, at a cost of Rs1250bn. Where is the money going to come from?

"Budget allocations (Rs120bn in the current ninth plan, for 1997-2002) are inadequate," says Mr Bhandari, "and private sector financing and aid from the World Bank and the Asian Development Bank."

Mr Bhandari says the users must pay. He approves of a proposal from the transport ministry to augment the government's central road fund by setting aside 5 per cent of the basic price of petrol and diesel. The fund currently receives Rs200m from the government through a levy of 3.5 paise per litre of fuel. The money is given to the states in proportion to their fuel consumption, and has to be spent on state road programmes. Funds for national highways come from the central government's consolidated budget; the current allocation covers around 30 per cent of what the ministry asked for.

Recognising that road programmes are impossible to finance through general budgets, the government introduced a levy of Re1 per litre of petrol last year for highway development. It expects to collect Rs7.9bn for the fiscal year to March 1999. A similar tax is planned on diesel, which would raise collections to Rs25bn, but the government has so far been unable to introduce it.

Foreign investors interested in entering the Indian highways sector are wary that the already long lead-time on road investments would be further prolonged in India, with the consequent risk of cost over-runs, compounded by the political and social risks of collecting toll charges. "The government has to improve the decision-making process, which is multi-layered, multi-agency, and time-consuming," says Mr Bhandari.

Long delays in paying contractors are among the hazards of Indian business life, often resulting in expensive litigation and arbitration cases. "There has to be a legal framework in place to protect private investors," says Petr Nexval, director of Pontex, a Czech engineering consultancy examining the highways project. "The build operate and transfer (BOT) process that the government has announced is not a good proposition for foreign companies."

Only 4% of roads conform to international structural norms

A team of senior bureaucrats from the National Highways Authority of India, an autonomous government organisation which will execute the project, and the ministry of surface transport are currently working to resolve these problems. International consultants have been appointed to draw up the legal documents required, and ensure that the competitive bidding is transparent.

"Quality control will be strictly monitored by appointing international supervisory firms, and we expect the foreign companies to bring in their latest equipment and technology," says R.Vasudevan, secretary of surface transport. "For our part, we will exempt road-building equipment from taxes, give subsidies of up to 40 per cent, facilitate land acquisition, and ensure that contractors are paid within a week of submitting their bills. We have to provide the BOT operators with sweeteners or private investment will be hard to attract."

Mr Thambidurai says: "This is the largest investment opportunity in the roads sector anywhere in the world."

The government has belatedly addressed one of India's worst infrastructural bottle-necks. India's roads will get a lot worse before they get better. Apart from being a serious drag on the economy, they are also among the world's most dangerous – in 1995 (the latest figures available) more than 70,000 people were killed and 30.7m injured in accidents involving motor vehicles. Only half of the 3.1m-kilometre network (the world's third-largest) is surfaced, and, according to a 1995 World Bank study, only 4 per cent of roads conform to international structural norms.

While freight and passenger traffic has increased 88 and 70 times respectively since 1951, road length has increased only sevenfold. The national highways, which carry 40 per cent of the total traffic, account for only 49,585km, or 1.65 per cent, of the road network.

The growing volume of traffic includes a tremendous variety of vehicles – fast-moving vehicles mix with trucks, rickshaws, bicycles, and even animals. The saturated and over-burdened roads are pot-holed and pulverised, and traffic snarls can stretch to 10 kilometres on some busy stretches.

The costs of poorly-maintained roads to industry are often incalculable, and invariably unsustainable. According to one transporter, the cost of moving a container by road from Delhi to Bombay (approximately 1,200km) is 55 per cent of the road and sea freight from Delhi to Hamburg.

A better road network would result in savings up to $8.6bn per year, according to the Delhi-based National Council for Applied Economic Research.

PRIVATISATION OF THE PORTS by Kunal Bose in Calcutta

Capacity and efficiency all at sea

Heavy congestion and long turn-around times need to be addressed in order to deal with rapidly-growing volumes

Cargo traffic at India's ports is expected to grow rapidly in the next few years, but there are concerns over the ports' ability to handle this trade given their existing capacity and inefficiency.

Rites, a federal government-owned consultant, has forecast that traffic totalling 251m tonnes last year will grow to 415m tonnes by 2002 and 1,273m tonnes by 2020. But some shippers say there will be a shortfall in handling capacity of nearly 90m tonnes at India's leading 11 ports – owned by the federal government – by 2003.

Heavy congestion, berthing delays, and long ship turn-around time are common features of Indian ports. The turn-around time of a ship at Cochin, rated one of the country's more efficient ports, is over four days; the situation is worse elsewhere.

The 11 main ports handle 90 per cent of India's cargo traffic, with the balance going to the 139 intermediate and minor ports under the control of state governments.

Shippers are not expecting port congestion to ease significantly in the near future, but what gives them hope is the speed with which the federal government is throwing open port development to the private sector.

The private sector is being asked to bear in mind long-term growth of traffic when building all-weather ports capable of handling large ocean-going vessels and take on lease assets of the existing main ports or create new assets there. The guidelines for private sector participation on build, own, operate and transfer basis provides for a concession period of 30 years.

The western Indian state of Gujarat, which is setting the pace for port privatisation, is allowing two large expansions of a port built by a private party during the concession period.

Gujarat Pipavav (GP) currently has capacity of 12m tonnes a year and is to be expanded in phases to 50m tonnes by 2008. "We have so far invested Rs3.5bn in building an all-weather, deep-water sea port," says the port's president, KP Vohra. "As we increase the port's cargo handling capacity to 50m tonnes, a further investment of Rs16bn is to be made. The port, designed to handle both solid and liquid cargo, will finally be able to receive ships of 120,000dwt."

Gujarat Maritime Board, a state government body, owns 26 per cent of GP. Mr Vohra says it is allowing Seaking Engineers, the private promoter, to manage the port affairs without "undue interference".

"Work at the port started in earnest in mid-1994 and the jetty was commissioned in November 1996," says Mr Vohra. "While the success of the port is underpinned by its excellent maritime features, the state government wants to project it as the model port when private parties come forward to bid for the 10 other identified sites."

The federal government's guidelines for private sector involvement in the expansion of the existing 11 main ports say such "participation would result in reducing the gestation period for setting up new facilities, help bring in the latest technology, and lead to improved management practices."

Describing port privatisation as an offshoot of the general liberalisation of economic policies, the government says the initiative is required to mobilise "substantial resources" needed for port capacity expansion and usher in "efficiency, productivity and competitiveness in port services".

The guidelines have identified several areas for private sector participation: construction and operation of container terminals, cargo berths, warehouses, container freight stations, tank farms, dry docking, and ship repair facilities. The main ports will have freedom to take on lease equipment and floating crafts from the private sector.

SK Mohapatra, chairman of Pradip Port, says "a major port like ours will go for privatisation if it cannot fund expansion or modernisation. Privatisation will also be triggered if it is felt that a private operator will lift efficiency. Ours is a profit-earning port. Still, we have given two berths to private parties for captive use. I think there will be more efficiency if we privatise our coal-handling."

Some of the privatisation programmes of leading ports are so capital and technology intensive that the local operators can bid for them only in association with foreign companies. JNPT, in Bombay, will be inviting bids for the construction and operation of a marine chemical terminal with initial capacity of 15m tonnes a year, rising to 25m tonnes. The investment needed is around $800m, and the port will entertain bids only from "established international terminal operators".

The private sector has shown little interest in taking on leases of the existing assets of the main ports. The stumbling block is overmanning; government policy provides for the port authorities to decide the labour complement that a private operator must accept when it takes an asset on lease.

The Major Port Trusts Act allows the ports themselves to take on the the role of a regulator. The government has, however, promised that for the "purpose of fixing and revising port tariffs an independent tariff regulatory authority will be set up".

Private investors will feel comfortable if there is an independent regulator. "There will always be scope for conflict between a port and private operators. "The risk involved in building and operating a new port is many times more than owning a facility in an existing port," says Atanu Chakravarty, chief executive of Gujarat Infrastructure Development Board.

"We do not have any experience of the private sector running ports. Investment in a port is of a long-term nature. It was a big challenge for us to formulate a port policy which will give comfort to private investors. We must not be seen to be giving away more than necessary."

URBAN FACILITIES by Mark Nicholson

Basic services are a daunting task

Current planned government expenditure on repair, renovation and extension for the next decade is just 10% of estimated need

Within a couple of years, one-third of Indians will live in cities – as many people as comprised the country's entire population at the dawn of independence 51 years ago, when only 10 per cent lived in main cities.

Urban population growth between 1981-91, the last time it was measured accurately, was 3.1 per cent, against 1.8 per cent in India's 680,000-plus villages. Wealth discrepancies between city and country are, meanwhile, rising fast.

More than half of urban Indians live without any form of sewerage system – only 200 of India's 3,600 biggest cities have sewerage systems at all. Nearly one-third of city dewllers do not even have toilets or latrines. About the same number have no refuse collection services, and 16 per cent of city-dwellers have no water supplies. Where such services do exist, moreover, they are under-funded, inefficient, often insanitary, and chronically ailing. Two-fifths of Delhi's urban water supply, for instance, goes "missing" through leakage and other inefficiencies.

Small wonder, then, that a top official with a leading international finance institution describes the challenge of addressing urban infrastructure simply as "daunting". In fact, until recently the World Bank had more or less disengaged from urban infrastructure projects. Furthermore, while foreign and private investors are beginning to show interest in urban water, sewerage and waste projects, the regulatory, bureaucratic, political and financial environments for such investments are, if anything, less promising than the already thorny sectors of power, telecoms, roads or ports.

The required investment is huge. "You have a quite colossal need for investment," says V. Suresh, the energetic chairman and managing director of the government Housing and Urban Development Corporation, which for 10 years has been heading the state investment effort. He says the estimated need for investment to repair, renovate, and extend current urban infrastructure over the next decade is $65bn, of which currently planned government expenditure for the sector would meet only one-tenth.

So far, much of the foreign and private investment interest has focused on provision of water and sanitation. Companies such as Anglian Water, the UK utility that has established a fully-owned subsidiary in Bangalore, and Vivendi, the French water utility, are either engaged in, or examining, prospects for water and sanitation projects in the main cities.

Among these, Pune municipal council is trying to put together a $187m water and sewerage project, Bangalore has plans for a 500m-litres-a-day water supply project, and Madras is looking to almost double urban water supplies – in each case the municipalities are seeking private investment in partnership with the local authorities.

The hurdles are manifold, as the private sector developers are discovering. These include problems of financing, regulation, and management.

For water projects, the problems of financing resemble those already encountered in private power projects, but are more acute. Indian consumers are used to receiving water at tariffs well below cost recovery rates, and there is stiff political resistance to allowing water tariffs to rise. But with water and sanitation projects financed on a non-recourse basis – that is, without financing secured against assets but only against cash-flows generated by the project itself – the viability of any water project relies on the developers' ability to charge remunerative tariffs.

Related to this is the issue of regulation, of which there is little in the water sector. In most cases, state governments set broad guidelines for water tariffs but leave it to municipal authorities to implement water supplies and organise distribution and billing. This, in turn, raises the question of management, since most municipal authorities offer limited expertise or incentive within their administrations to organise and police efficiently anything resembling a commercially viable water distribution system.

There is a limited willingness to pay among consumers, little political will to make them pay, and no effective regulatory system to police the sector, set standards, or hold local urban authorities accountable.


Precious water: 16% of city-dwellers have no direct supplies AP

For this, and other reasons, many developers are questioning the viability of big BOT or BOO water projects, which require huge initial investments but rely on tight and commercial distribution systems. Moreover, investors are increasingly discovering the complexity simply of preparing a bid for such projects. Mr Suresh points out that it took more than two years of study and preparation by bidders to the Pune water project – only for the local government to decide at the last minute that it wanted the whole process retendered.

In addition, some investors believe that the whole concept of most tenders is misplaced, and that tender documents place too much emphasis on engineering practicalities rather than financial concepts. Given the inexperience of the tendering municipalities, global water companies are frustrated by the imprecision of the tender documents.

The chairman of one European water company recently complained that his group had been invited to bid for "one sewerage system, complete item" for a south Indian city and was given a six-year-old street map of the city as the basis to prepare the bid. In the event, he says, his competitor entered a bid which included fully 200km more sewerage tunnelling than his own.

Nevertheless, the lessons of such experiences are being learned. Having also learned from the difficulties faced by foreign contractors entering India's power, telecoms, ports, and roads sectors, government agencies increasingly recognise what needs to be achieved to attract investment into urban infrastructure. There is, for example, an increasing recognition among officials of the need for effective regulatory authorities to oversee water and sanitation. Andhra Pradesh state has already begun work towards establishing such an agency.

FINANCIAL TIMES SURVEY http://www.FT.com/ftsurveys/

THE PINK BOOK

FEBRUARY 26 1999 **QUARTERLY GUIDE**

In this issue

Employment policy • Economic statistics and forecasts • Foreign exchange and bond markets • Euro-zone 11 - statistics and analysis • Taxation • Motor industry • Monetary unions. **Next Issue: May 28 1999**

MOTOR INDUSTRY by Haig Simonian

A market facing up to pricing reality

The car industry in Europe is going through one of the most intense periods of restructuring in its recent history, and this year's introduction of the euro seems certain to be one of the driving forces that will see the process continue.

Spiralling costs, static demand, and rising competition have been behind the moves which have brought such venerable names as Rolls-Royce into the embrace of BMW, Volvo into the ownership of Ford, and even put BMW itself into the spotlight as a result of its difficulties with its Rover subsidiary in the UK.

The new pressure that is now arising, however, comes from the pricing transparency across previously separate national markets which is being brought about as a result of economic and monetary union.

While a single market

'Greater price transparency will highlight apparent anomalies in pricing'

nominally existed before the start of this year in the EU, manufacturers were able to shelter behind national currencies and to price at the level each market was deemed capable of bearing. Attempts by indivdiuals to buy outside their home countries were made notoriously difficult.

"As we move towards economic and monetary union, one of the last visible barriers to different car prices across Europe appears to be on the way out," says Greg Melich, motor industry analyst at Morgan Stanley Dean Wittor in London. "Whether Emu is the coup de grâco of variable car pricing remains to be seen, but it certainly creates the opportunity for greater visibility in pricing. Full convergence could take another three or five years, or Emu could accelerate it," he predicts.

Carmakers have already received an intimation of the risks ahead. Last year, Volkswagen, Europe's biggest carmaker, was fined Ecu105m by the European Union for allegedly anti-competitive behaviour. According to the charges, which are being contested, VW discouraged dealers in Austria from selling vehicles to Italian customers.

The enterprising Italians had noted they could buy VWs more cheaply in Austria than at home because of exchange rate movements. With none of the handicaps of right hand drive or a Channel crossing facing UK motorists, the Italians simply hopped across the border and took their calculators. For those from the German-speaking Alto Adige, not even the language was a barrier.

The arrival of a single European currency should make such practices even more commonplace as consumers grow more sensitive to inexplicable price differentials for new cars. Greater price transparency will highlight the apparent anomalies in pricing, thrown into the sharpest relief when local sales taxes are excluded.

Generally speaking, Europe's carmakers tend to price their products relatively cheaply in countries, such as Denmark, where sales taxes on new cars are highest. That tends to level out price differences, including tax in the EU.

But for canny buyers willing to take on the relatively easy task of handling the local bureaucracy, buying in a foreign market for export, and thus free of local taxes, can be rewarding, even once the appropriate sales taxes are paid at home.

The advent of the common currency should accelerate that process, which may be further facilitated by growing use of the internet to gain information and arbitrage prices.

Already, there are a signs of change. Fleet buyers, the most professional operators in the business, are exploiting opportunities to cut their car purchasing costs. Several UK fleets, which already benefit from massive discounts in the home market, are moving to pan-European buying in an attempt to secure even lower prices by placing larger orders.

Seperately, Broadspeed, a Colchester-based car engineering and sales group, is planning to set up outlets on cross-Channel ferries operated by the Stena line to help British motorists wanting to buy cars through cheaper dealers from the Netherlands. The arrangement, due to start in March, could offer UK drivers savings of up to 40 per cent.

However, the speed of change – and its likely impact on car companies – should not be exaggerated. Before any really significant rise in consumer arbitrage for cars, Europe's system of selling vehicles will probably have to be changed.

The current method, called block exemption, gives vehicle makers immense power over their independent dealers. It looks set to be abolished when it comes up for renewal early next century. However, "until this system is reformed we believe that it will be virtually impossible for market forces to bring about price harmonisation with or without the euro," notes Keith Hayes, motor industry analyst at Goldman Sachs in London.

Once block exemption goes – as seems almost certain – consumers will have the opportunity to shop around more aggressively. The removal of the current rules will also encourage the creation of independent brokers, ready to help motorists buy new cars more cheaply.

Only then will the full impact of the single currency be felt fully by the motor industry. The likely impact will be to reinforce existing competitive and financial pressures, increasing the chances of further concentration.

Jacques A. Nasser (left, foreground), of Ford, and Tuve Johannesson and Leif Johansson, of Volvo; and Jürgen Schrempp (left, rear), of Daimler-Benz, and Robert Eaton, of Chrysler: architects of motor industry mega-mergers in response to pressures which price transparency will now exacerbate

Montage: Phil Hunt, pictures: AP

TAXATION by Emma Tucker in Brussels

Lack of co-ordination a bar to further integration

The arrival of the euro has blown the covers off the debate about tax harmonisation in Europe. Long the European Union's most taboo subject, government leaders are now openly addressing the need for greater fiscal harmonisation. To the horror of the UK and other sovereignty conscious nations, France and Germany are calling for an across the board review of the many tax distortions and differences that plague the 15-nation single market.

The economic logic is compelling. The absence of tax co-ordination is a gaping hole in the single market – a barrier to further integration in all areas from financial services to the free movement of people. Harmonisation would put companies on an equal footing and ensure the smooth functioning of the euro-zone.

In spite of the arguments, a massive shake-up of tax policy is not about to happen. At least for the time being, all taxation decisions have to be agreed unanimously. As a result, countries that feel uncomfortable with further integration – such as Britain – can be expected to stand in the way of radical change.

Even the limited taxation proposals currently on the table are likely to face a rough ride. Those comprise a tax "package" drawn up by the Commission, aimed at ironing out unfair tax competition.

The package, drawn up by Mario Monti, the single market commissioner, falls well short of wholesale harmonisation. The aim is specific: to iron out gross distortions to the single market created by "harmful" tax competition between member states. It contains three elements.

First, a voluntary code of conduct on business taxation, which commits member states to phasing out tax breaks granted to specific sectors or regions that lure inward investment at the expense of neighbouring countries. This measure was prompted by high-tax countries such as France and Germany that believe they are the victims of special low-tax schemes in countries such as Ireland.

Second, a legislative proposal for a minimum 20 per cent withholding tax on income from the savings and investments of non-residents. At the moment 11 of the EU's 15 member states do not tax interest on the savings of individuals based in other member states – a ploy to attract capital. However, it also means that member states lose out on valuable revenues.

The last element is a proposed law to make it easier to transfer interest and royalties across borders without the risk of double taxation.

That is as far as current activity by the Commission extends. On value added tax, a minimum rate of 15 per cent prevails but there are no plans to harmonise rates further. Nor are excise

EMPLOYMENT POLICY by Robert Taylor

EU has eye on bridging gap with competitors

The arrival of the euro is accelerating efforts to try and develop an integrated and co-ordinated European employment strategy to complement the prudent fiscal management of the central bank. Unless concerted action starts to cut unemployment levels significantly over the next few years, there is a danger that economic and monetary convergence will heighten social tensions by increasing the numbers out of work in poorer regions. This is why the European Commission and EU member state governments are trying to hammer out a common programme that will modernise European labour markets. An employment pact is promised by the time of this summer's EU summit in Cologne.

The outlines of what is a new approach to employment are already becoming clear. The emphasis will be on the development of policies designed to increase the proportion of people of working age who are in work. The European Commission, inspired by the strategic thinking of Allan Larsson, director-general of social affairs, believes a strong potential exists for employment expansion through a shrewd mixture of demand and supply side measures.

Contrary to conventional wisdom, the EU's labour markets have not always been sclerotic in employment creation. Twenty years ago its employment rate (the number employed relative to population of working age) was broadly similar to that of the US and Japan. But the latest comparative statistics available show that, in 1997, only 60.5 per cent of people of working age in the EU were active in the labour market compared with 74 per cent in the US and Japan, although the employment rate ranges from 77.5 per cent in Denmark to 48.6 per cent in Spain.

The task facing Mr Larsson and his colleagues in EU member states is how to narrow the overall employment rate gap between the EU and its main global competitors. Certainly, a consensus appears to be emerging that represents a break with the past emphasis on social protection and passive benefit measures aimed at safeguarding the living standards of the unemployed.

The new approach is based on what Mr Larsson describes as the four pillars of an employment strategy: employability; entrepreneurship; adaptability and equal opportunities. Taken together, they represent a clear shift to a more active public policy to reshape the EU's labour markets.

In its employability agenda the EU approach aims to focus specific attention on improving the employment position of women, young people and all adults above the age of 65. The call for more education and training has become an unthinking mantra, but raising skill levels in information technologies remains a vital ingredient in lifelong learning strategies.

Mr Larsson is particularly keen to see policies that prevent those without work drifting into long-term joblessness. At present, 4m, almost half the EU's unemployed, have not worked for more than six months. He argues that governments should not wait for those people to become part of the hard core before offering them a way back into work.

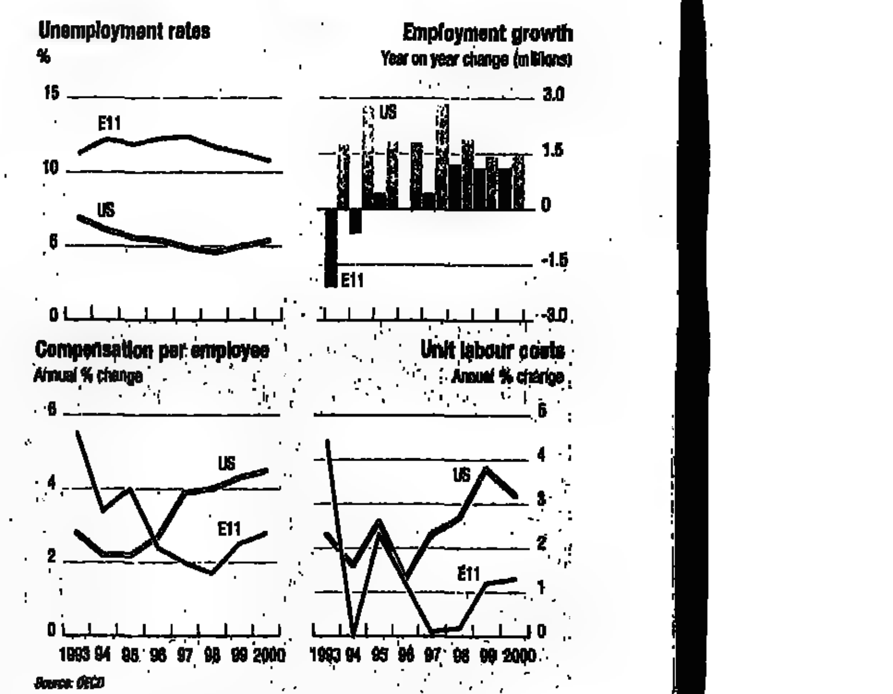
The second pillar of the strategy concerns the creation of a "new culture of entrepreneurship". This means active encouragement of business through tax incentives and other supports in the private services sector. The Commission believes more employment will have to be generated from hotels and restaurants, financial and business services, health and education provision and information technology services through growth in part-time as well as full-time employment.

The third pillar involves a greater commitment to workplace adaptability. As Mr Larsson argues, this means integrating social policy with strategies of production through the creation of partnerships at enterprise level. Flexible working time patterns and new skills can help facilitate corporate change by consensus.

The fourth pillar of equal opportunities involves the encouragement of policies designed to reconcile family and working life with a conscious effort to encourage more women to participate in the labour market.

The Larsson employment agenda is designed to complement the EU's economic strategy of stability and growth. It seems to have won the approval of European employer associations and trade unions which have pledged themselves to work together in promoting its balanced application in national economies. But whether it can survive the uncertainties of the global economy and financial markets is another matter.

The EU has made commitments before to employment targets which events have overtaken. This time there seems to be more substance and common agreement about what needs to be done. Certainly, the centre-left governments that dominate the EU are going to give a high priority to employment creation. For the time being Mr Larsson's Swedish way seems to have achieved a European dimension.



EMPLOYMENT PATTERNS by Ron Martin and Peter Tyler

No panacea for market weaknesses

From the outset of monetary union there has been a rather optimistic view that, within a relatively short time, significant benefits will begin to flow to residents and businesses in the founding member nations of the euro-zone.

That there are very real economic gains from Europe's currency union is not in question. What is debatable is whether socio-economic conditions exist for the benefits suggested by the theory of an optimal currency area to be realised in a painless, equitable, and thus harmonious, manner. A full cost-benefit assessment of the impact of monetary union is likely to remain elusive, for a number of reasons.

However, very few commentators doubt that there are going to be quite substantial shocks to both product and labour markets across Europe. Attention has focused on the ability of European labour markets to adjust to the inevitable competitive pressures that monetary union will generate. In a unified monetary union any failure of an individual region to remain competitive falls on the domestic cost base of its traded goods sector, since every region has the same exchange rate and, for that matter, interest rate. Over time, the prices of tradeable goods will converge across the whole of the EU. Regions with relatively inflexible cost bases will experience rising unemployment and/or substantial net outward migration in the absence of offsetting fiscal transfers from a national, or European, fiscal authority.

Recent research of ours suggests that there are at least some grounds to believe that the benefits arising from monetary union may not be spread across Europe in a very even way, particularly for the more peripheral regions. The problem is that many regional labour markets do not appear to be flexible enough to adjust to the discipline imposed by monetary union.

Rising unemployment across the Union throughout the last 20 years has been spread very unequally, with differences between regions within most nations often greater than between member states. However, there has been very little evidence of any widespread convergence of regional labour markets across Europe in terms of unemployment rates. Regional unemployment disparities have been persistent, with the ranking of regions in terms of their relative unemployment remaining remarkably stable over time.

This is in stark contrast to the picture in the US, which is the sort of currency union many commentators hope the European Union will emulate. In the US, regional labour markets appear to adjust relatively quickly to prevent labour demand and supply shocks leading to large and persistent regional unemployment disparities. There, one period's high unemployment region is unlikely to be the next period's, unlike the EU situation.

Our work suggests that in the EU the persistence of regional unemployment disparities is influenced by a number of factors.

One is the inability of Europe and its individual regions to generate jobs. Over the last two decades, while unemployment rates in the EU have risen to historically high levels, they have remained relatively low in the US. The US has generated several million new jobs, a rate three times that of the EU. In the US, throughout the past two decades, most regions have expanded their employment bases by between 1 and 4 per cent a year. In Europe, some regions have experienced a decline in their job base and very few have managed to exceed a growth rate of 1 per cent a year.

However, a second and important factor is the influence of migration and labour market mobility in general across the regions of Europe in comparison with the position in the US. There, labour migration is the primary mechanism by which regions adjust to labour demand shocks. The problem in the EU is that inter-regional migration rates are substantially lower than those in the US and linguistic and cultural barriers mean mobility across state boundaries is always likely to be lower than among US regions.

A third factor relates to regional variations in real wage flexibility. We have sought to identify regional variations in this. There is a degree of wage rigidity in the peripheral regions (northern UK, northern Germany, southern and western France and southern Italy) at least twice that in the central, more prosperous and

'Regional unemployment disparities have been persistent'

economically dynamic regions.

European regional labour markets are going to take time to adjust to the competitive shocks induced by monetary union. They are likely to do so in a highly asymmetric manner given the absence of any significant changes in the ability of Europe to generate more jobs, any increase in inter-regional migration and a more even process of inter-regional fiscal transfers – all of which currently exist in the US.

Past experience throughout the whole of the post-second world war period suggests that the economic benefits which arise from greater European integration, of which monetary union is the latest phase, cannot be left simply to trickle down as a result of market forces to those citizens who are in Europe's periphery. On grounds of both equity and efficiency more needs to be done by both individual member states and the European Union as a whole to assist the peripheral regions in their integration process.

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Peter Tyler is in the Department of Land Economy and Ron Martin in the Department of Geography at Cambridge University. Both authors are members of the Cambridge Centre for Urban and Regional Studies, Department of Land Economy, University of Cambridge.

CASE STUDY
BANCO BILBAO VIZCAYA

Three-year effort gives smooth start

There were a few cases of corporate bonds being wrongly converted, with figures multiplied by the new euro rate instead of divided. And some stock market screens refused to show euro values with decimals. After all, it had been a long time since fractions of Spanish pesetas were worth counting.

But these were only minor incidents. All in all, the euro's start-up took place smoothly, says Jesús Pizarro, one of a dozen-strong team at Banco Bilbao Vizcaya supervising the changeover at the bank and its network of 2,800 Spanish branches.

"It went pretty much as expected," he says. "The question was whether the whole system would collapse. But it didn't happen." The relatively accident-free process, in this and other Spanish banks, he comments, belies the reputation of Spaniards for being poor at preparation and having to rely on their talent for improvisation.

The bank had been preparing for the euro for three years, an effort reckoned to have cost it

'Ability of brokers to handle new pricing system put to the test'

about Pta12bn (€72m). Adapting to the euro meant changing 33,000 computer programs. All the group's 24,000 employees in Spain went through training courses, with an intensive training boost in the last three months.

Over the "conversion weekend" 520 central BBV staff were at work, mainly at the bank's computer centre. Some 1,200 accounts, mostly belonging to companies, were redenominated in euros. A branch in the yuppie Madrid suburb of Majadahonda had a pilot working day on Sunday, January 3, with staff acting as clients carrying out virtual euro operations, reporting back any lessons so that they could be passed on to other branches.

Share trading in euros began from January 4, in a period when slow business could usually be expected on the Madrid exchange.

The ability of brokers, of which BBV is one of the biggest, to handle the new pricing system was put to the test rather more brutally than planned, as investors reacted frantically to the Brazilian financial crisis and then to a surprise mega-merger announced between two of BBV's main rivals, Santander and BCH.

"We would have liked to have had a few quiet days," admits Mr Pizarro. The few slip-ups in the launch period were rapidly policed, and both the stock market and the new payments systems functioned satisfactorily.

"Everything was absolutely controlled," says Madrid-based colleague Javier de la Nava, also working in BBV's euro co-ordination unit.

A special trouble-shooting centre was set up by the bank for the changeover. It is due to stay in place for about a further six months.

With customers now free to re-denominate their accounts or keep them as they are, there has been no avalanche of demand for euro accounts, he says. The process is expected to take place gradually. "It's a novelty. People make inquiries about it. There are some who do it out of snobbery rather than necessity," he says.

Individual clients have so far shown little tendency to break the peseta habit, even to buy and sell shares. They make their orders in pesetas, which are then converted into euros, and have their proceeds converted back into pesetas. Bigger corporate clients have already switched to euros for international operations, but in general companies are expected to make the move only when they change to euros for their internal accounting. There may, he expects, be a bigger flood of demand for euro accounts at the start of next year.

The first phase of training staff for changeover has been completed, Mr de la Nava says. But more will be needed for the complicated period in early 2002 when euro notes and coins are due to begin circulating. The bank will continue providing support to staff and clients, *through written manuals*, a website and special telephone "hot lines".

David White

UK by Richard Adams in London

Recession hovers in the wings

UK economic growth continued to slow towards the end of last year – to the most sluggish rate since the last recession. But it wasn't slow enough to please some analysts.

Official estimates showing quarterly economic growth of just 0.2 per cent in the last quarter of 1998 caused surprise, as growth was expected to be non-existent or even negative at the year's end.

Survey evidence of weak activity in the manufacturing and service sectors, and the need to reduce interest rates by the Bank of England, had caused many analysts to predict that a recession had already begun in October.

But the official figures were boosted by the continuing strong performance of the service sector. Private and government services make up nearly two-thirds of the economy, and the sector's performance is a sharp contrast to other areas of the economy, with 2.9 per cent annual growth.

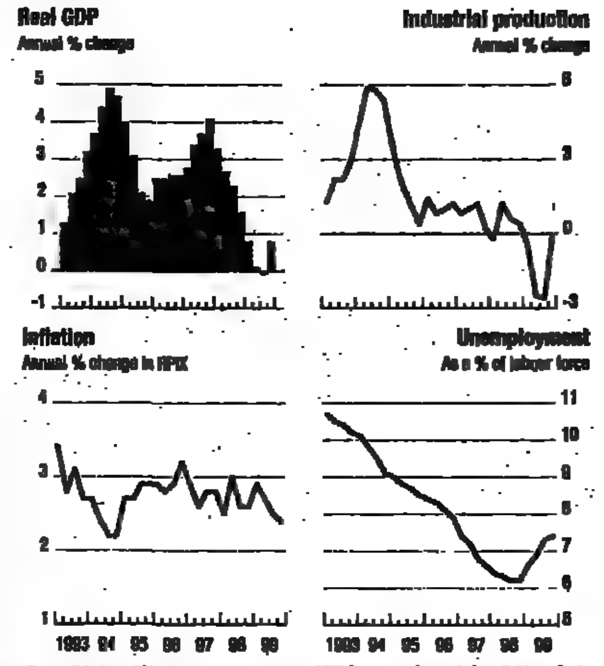
Manufacturing has performed as poorly as predicted by many of the pessimists. Its performance has been exaggerated by the strength of sterling over the past two and a half years, depressing demand for UK exports.

Recent surveys suggest that the slight easing of the pound's strength has helped improve sentiment in the export sector. But the UK's trade deficit is likely to widen significantly before any improvement is seen.

Many predictions of a slowdown were based around the very weak levels of consumer spending during the second half of 1998.

Retail sales volumes in December grew at an annual rate of just 0.7 per cent – compared to growth of 5.6 per cent in 1997.

But the lack of consumer enthusiasm for spending should come as no surprise: growth in household wealth slowed abruptly for most of 1998, reflecting tight monetary conditions of higher interest rates and a strong currency.




No surprise at lack of consumer enthusiasm for spending AP

DENMARK by Clare MacCarthy in Copenhagen

Pace-setter shows signs of tiredness

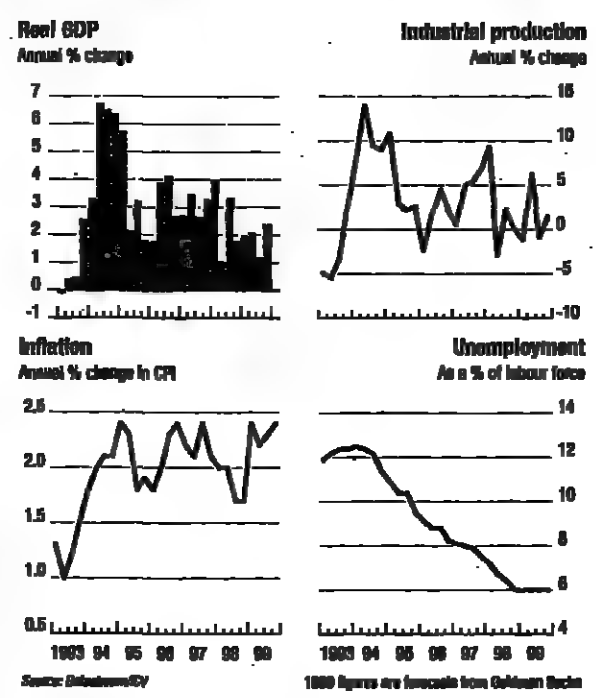
Economists give Denmark a fit bill of health but with the proviso that it is not quite as sprightly as it has been. Between 1993 and 1998 the country experienced an average annual gross domestic product growth of 3.5 per cent, making it a pace-setter in a European context. However, two fiscal tightening packages implemented by the government within the space of six months last year will curtail the economy's expansion and the government estimates that 1999 GDP growth will drop to 1.6 per cent and decline further to 1.2 per cent in 2000.

Market economists are rather gloomier about the immediate term and Den Danske Bank, Denmark's largest lender, predicts that GDP will slump to 1 per cent this year, though it will pick up again to around 2.25 per cent in 2000.

The economic growth of the past few years was primarily fuelled by private consumption, and a sharp drop in Danish mortgage lending rates, mirroring EU interest rate convergence, freed up additional spending power for consumers last year and brought the economy to the brink of overheating. But, while the general public's spendthrift ways have been largely addressed by last year's twin austerity packages, economists say the government needs to act to reduce public-sector consumption.

A sharp decline in Danish industrial competitiveness is another concern. The decline in exports seen last year is expected to extend into 1999, keeping the current account in deficit until at least 2000. The government expects the deficit to hit Dkr6.5bn (€874m) in 1999 before narrowing to Dkr2bn next year.

However, there are some sunny points. Inflation is modest with the consumer price index running at 1.7 per cent and will remain benign and well under 2.5 per cent for the next two years. Similarly, the unemployment rate, in double-digits only six years ago, has eased to just 6.1 per cent.



THE PINK BOOK

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In this issue

Next issue May 28 1999

Editor: Nicholas Leslie
Design: Philip Hunt
Statistical research: Chris Flood
Front cover illustration: Andrew Burns
Graphics: Robert Hutchison and Joe Russ

Editorial inquiries:
Please fax
The Editor, European Economic Survey +44 (0)171 873 3197
or email: nick.leslie@ft.com
Financial Times
Number One Southwark Bridge
London SE1 9HL

INTRODUCTION by Wolfgang Münchau in Frankfurt

Financial markets biggest beneficiary of euro so far

Whatever the expectations to the contrary, monetary union is about political power, and will not prove to be a panacea for Europe's economic problems

The launch of the euro on January 1 counts as one of the key landmarks in the history of European integration following the inception of the European Economic Community in 1958 and the single European market in 1993. Few other events have involved such a large transfer of sovereignty from a national to a European institution.

While most of the attention has focused on the euro itself, economic and monetary union has also brought about an entirely new economy, the euro-zone. Like the euro itself, the euro-zone is more than just the sum of its constituents. It is an economy in its own right, with its own economic statistics and distinct economic characteristics. Individual members of the euro-zone no longer exist as relevant macroeconomic units. Their governments have renounced the right to print money.

Economic and monetary union is primarily a political project. At its deep core, it is not about money but about power. As a political project, Emu's ultimate goal is to establish further political integration, primarily – though not exclusively – in the field of economic policy.

Emu is bound to disappoint those who have favoured the project for perceived economic reasons. Professor Paul Krugman, of the Massachusetts Institute of Technology, speaks for a majority among academic economists when he predicted that Emu would turn out to be economically neutral, and not an economic event of the first order.

Nor will Emu solve Europe's economic problems by itself. Europe will still suffer from high unemployment, and Europe's large and persistent current account surplus with the rest of the world will not disappear either. Forecasts suggest that the effect of the euro on the growth and well-being of the European economy is negligible, a few decimal points of growth at the most, less than the error margins normally contained in such forecasts.

Whether Emu succeeds as a political project will depend on the willingness by Europeans to embrace further political integration, on the quality of Europe's economic policies, and on whether the European Central Bank and national governments achieve the optimal policy mix for the euro-zone economic area. Even though the euro-zone is now a distinct economic area, national governments continue to remain in charge of fiscal policy. This imbalance is a potential source for conflict, which calls for extensive policy co-operation among the 11 participating governments.

For most euro-zone citizens, the arrival of the euro has had relatively little immediate impact, except that some prices and most bank statements are now displayed in both euros and national denominations.

Euro banknotes and coins are not scheduled to be introduced until early 2002. Some European finance ministers have pressed for an earlier introduction, but most experts doubt whether this is feasible.


The euro arrived with a bang on international financial markets AP

Meanwhile, the euro has arrived with a bang on the international financial markets, just as many of its supporters had predicted. The first weeks of trading suggested that prophecies of a bipolar financial world, in which the dollar and the euro would jointly dominate the global markets, no longer sound as absurd as they did only a few months ago.

During the first months of trading the euro outstripped the dollar as the largest currency in international bond markets. Some analysts regarded this as a fluke, but no national European currency would have been able to pull off such a stunt. Many foreign central banks, including those of China and Japan, indicated that they would exchange part of their dollar foreign exchange reserves into euros.

The euro also unsettled London's money market establishment with the news that Euribor, the new money market benchmark interest rate set up by a group of banks in the euro-zone, has proved more popular than London's time-honoured Libor rate as the benchmark instrument of choice.

But the success of the euro in international financial markets contrasts starkly with the continued economic problems in the euro-zone, and the uncertain outlook.

Unemployment in the euro-zone is running at levels close to 11 per cent, while inflation was down to 0.8 per cent in December, the lowest level since the start of the harmonised index of consumer prices (HICP) in 1995 – the result of falling energy prices (down by 4.7 per cent in December).

Economic growth has held up relatively well despite last year's economic turmoil in Asia and Russia. After annual economic growth of 2.5 per cent in 1997, the euro-zone economy experienced an upsurge in annual growth during the first quarter of 1998 (3.7 per cent), and a mild slowdown in the second and third quarters (2.9 and 2.7 per cent respectively).

Analysts are forecasting a further slowdown for this year, with most 1999 projections ranging from 1.5 per cent to 2.5 per cent. While the actual economic data portray a reasonably optimistic economic scenario, opinion surveys suggests much greater uncertainty.

The economic sentiment index for the euro-zone showed a gradual decline from 4.5 in May last year to 1.4 in December. While consumer confidence remains at record highs, industrial confidence is weakening – the main reason for the decline in overall sentiment.

Purchasing managers surveys, considered to be among the better forward-looking indicators of economic activity, also point towards troubles ahead. The various PMI indices for the euro-zone, including those measuring sales and new orders, are significantly below equivalent figures for the US. The data suggest manufacturing activity is falling in the euro-zone, but is still going up in the US after over seven years of economic expansion.

If the surveys are right, interest rates may fall further. Short-term real interest rates are close to 2.3 per cent, according to the ECB, while nominal real interest rates are around 3 per cent. This level of real interest rates suggests a relatively moderate monetary policy stance, though not excessively loose either. Many economists predict a further decline in euro-zone interest rates, possibly during the remainder of the first or in the second quarter this year; that would bring real interest rates to below 2 per cent.

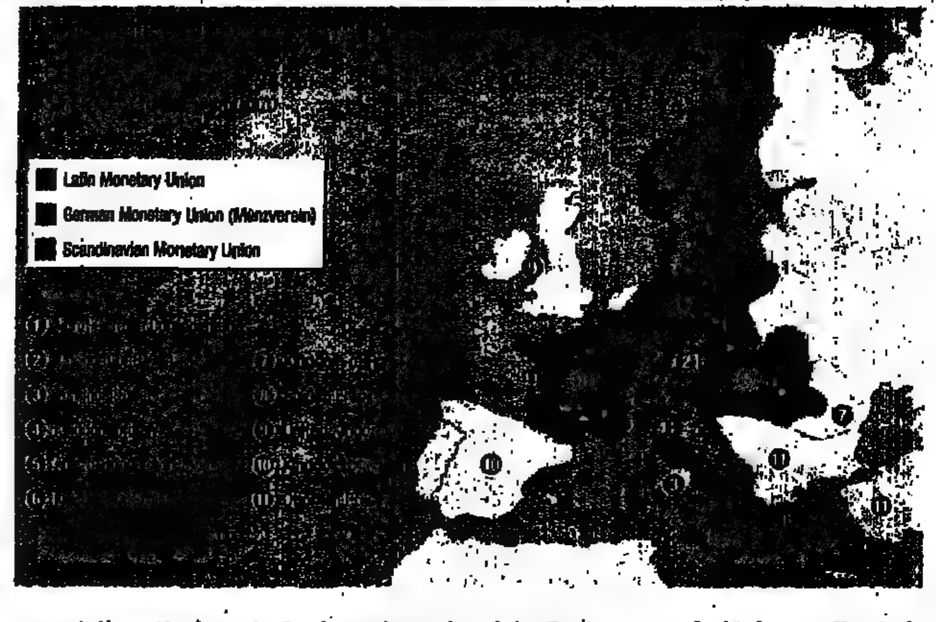
Given the stickiness of prices in the service sector (where price inflation was still running at 2 per cent in December), it is highly unlikely the euro-zone faces the prospect of outright deflation, if deflation is defined as a medium-term decline in the price level. Nevertheless, Europe faces the risk of an economic slowdown – a cocktail of low inflation, low growth and high unemployment. This would put the ECB under intense political pressure to cut interest rates further.

Another source of potential conflict is the exchange rate policy for the euro. Several European finance ministers, including Oskar Lafontaine of Germany and Dominique Strauss-Kahn of France, have come out in support of target zones or other systems designed to prevent excessive currency fluctuation between the main international currencies. The ECB rejects this on the grounds that target zones would eventually lead to a conflict with its mandate to achieve price stability in the euro-zone.

As ever, the risks and the opportunities remain finely balanced. European governments have so far demonstrated that they can muster the necessary political will and prove the pessimists wrong, for example when they succeeded in consolidating public finances during the late 1990s. But this was driven to a large extent by the fear that they might miss the qualifying criteria for the single currency. What they must now do is to continue in this spirit without this threat.

MONETARY UNIONS by Luca Einaudi

History offers a pertinent lesson



The difficult relationship between national or local identities and monetary unification is not a problem typical only of the 20th century. Italian and German monetary unification (in 1862 and 1871), together with the German, Latin and Scandinavian monetary unions (formed in 1838, 1865 and 1872 respectively), similarly presented governments with the complexities of monetary integration in Europe.

One of the lessons of the 19th century monetary union is that a complete and articulate set of rules within the union is the best guarantee for local interests rather than a struggle for the survival of national symbols in every possible situation. Full consideration given to the opinions of all participants when the common monetary policy is decided is a key issue, together with the prevention of free riders threatening the cohesion of the monetary union.

The structure and rules of today's Emu, from the European Central Bank to convergence plans and stability pact, are a response to problems experienced in 19th century monetary union. The choice of preserving national symbols on one side of euro coins but not on euro bank notes is also an appropriate response to persistent identification with local symbols, without weakening an efficient and credible control of monetary issue by ECB.

Money has always had a strong political character, for reasons such as the financial interests related to the control of monetary issue, particularly profits accruing to the issuer (seigniorage). Furthermore, coinage is a medium for political propaganda, especially through the strong sense of identity associated with the symbols of statehood it carries.

Various techniques were developed in the 19th century in order to balance the need to introduce a simple monetary system, which was reasonably centralised and safe from fraud, while preserving some degree of autonomy and respecting separate identities. In the end, the most obvious solutions did not necessarily provide an adequate level of cohesion.

The Latin Monetary Union (1865-1926), formed by France, Italy, Belgium, Switzerland and Greece, was a very flexible system but not a successful one. Each state maintained its original national currency, tying it to that of its neighbours with a fixed, non-readjustable exchange rate of 1 to 1. Only gold and silver coins were included in the union, but this reflected the limited use of bank notes in the area.

When appropriate national symbols did not exist, they were created for the purpose, as Spain did in 1868. The new Spanish government was keen to join the LMU, to "embrace its European brothers", freedom, civilisation, trade and wealth. A repudiation of the Bourbon crest and the invention of a truly national emblem were perceived as a triumph of national aspiration, blending perfectly with a monetary union.

When attempts were made to enlarge the union between 1866 and 1870, trying to convince the British and the Germans to join, it was proposed to keep a national symbol on common coins (usually the portrait of the local sovereign). A common reverse would indicate both the original local value (pounds, thalers or florins) and the common international unit (the franc of the LMU). To simplify calculations and facilitate transitional arrangements, simple exchange rates were planned (5 or 25 to 1). Robert Lowe, chancellor of the exchequer in Gladstone's government, wanted to join the union in 1869, fearing isolation if Britain remained excluded. The familiar concepts of conspiracy and attack on the sanctity of the pound were employed to rebuke him and defeat his attempt.

Economists and politicians often over-emphasised the conservative attachment of people to old and familiar symbols. In fact, once a clear advantage was perceived, the population gladly accepted to replace confused and fragmented monetary systems with a single modern one, with rather short transitional periods.

The LMU was meant to work permanently, like today's Emu in the transitional phase of 1999-2002, before the introduction of coins and bank notes. But the LMU had no official central bank, since banknotes were excluded from the union, nor any other common institutions – only inter-governmental conferences.

A French economist proposed, without success, to form an international central bank for the union, rotating its headquarters from one country to another every four years, to prevent the overwhelming influence of any single country on the Bank.

The incompleteness of the rules of the union and its excessive flexibility soon became a problem. Decentralised issue led to abuses in the Pontifical States and Greece, and to excessive issue of bank notes in Italy. The large number of foreign coins circulating lawfully in France thanks to the LMU made it difficult for consumers and merchants alike to distinguish them from similar coins minted in Spain, Latin America and the Balkans. The French government was forced to issue posters depicting 60 types of national and foreign coins which could be accepted and 34 illegal types which should be expelled from France.

After Bismarck chose to complete the German political unification in 1870-71 with a national war against France, further discussion about a European monetary

'When appropriate national symbols did not exist, they were created'

unification was only a rear-guard action. Rather than adopting a multiple of the franc as the new German currency, the German parliament was more tempted to accept a playful proposal to call the double mark a "bismark".

The real Bismarck defended symbolic concessions to the separate identities of smaller German states from the centralising zeal of German national liberals.

The strength of his solution was that concessions to particularists were exclusively symbolic. The amount of coins issued by local states was decided centrally. A single central bank – the Reichsbank, the predecessor of the Bundesbank – controlling all paper money was created for all of Germany. Bank notes carried exclusively the common symbols of the empire and not of the local sovereign.

Today's provisions for a national side of the Euro coins are fully adequate to satisfy reasonable requests of national identity within a common framework. To extend the presence of national symbols on bank notes would create the risk of a re-nationalisation of the currency.

If a member country of Emu were faced with a political or economic crisis, a form of discrimination against the euro bank notes of that country could appear, reintroducing a sort of discount and therefore an exchange rate fluctuation, which would cancel the benefits of the single currency.

A well known definition of the terms federation and confederation identifies the supporters of the latter simply with those wishing to prevent any real union from being formed. In a similar fashion supporters of very large concessions to local sovereignty and symbolism are simply attempting to weaken the chances of success of monetary union.

Luca Einaudi is an Italian economic historian.

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duties, other than those on energy products, being tackled.

In spite of the hugely disparate rates of duty charged on alcohol and cigarettes, the Commission has chosen not to pursue earlier proposals to bring the rates more into line.

Income tax has never been on the agenda and is never likely to be. Such a move would go well beyond the bounds of what is necessary for the smooth functioning of the single market and would anyway have potent political implications. For example, it would require member states to redraw social welfare systems.

Even the limited measures being pursued by the Commission have their critics. Unice, the European employers federation, is worried about the motivation behind the tax package. It fears that the focus of the proposals has become the need to maintain member states' tax revenues, rather than the need to eliminate tax obstacles to cross-border business activities and investment.

It points out that most member states have increased their overall tax burden in order to comply with the budgetary criteria imposed by economic and monetary union, and the priority of any initiative must be to reverse this trend.

"EU initiatives should not be used as a pretext to thwart this objective. This is a central question for improving European competitiveness," says Unice.

Unice does not believe that full harmonisation of corporate taxation will ever be needed in the EU. However, it is urging the Commission to take forward proposals for a European Company Statute. This optional structure would "provide an appropriate instrument to overcome legal and tax obstacles which effectively prevent the emergence of integrated business units on an EU-wide scale."

The Monti tax package may also hit the rocks if Britain and Luxembourg refuse to lift objections to the proposals for a withholding tax on savings. Britain argues that the plans will drive euro-bond trading offshore, damaging the City of London and the EU's general economic interest.

However, both countries are expected to come under heavy pressure not to scupper the plans, pressure the UK would find hard to resist if it is serious about joining the single currency.

These are small beginnings. However, a head of steam is building up behind calls for further tax harmonisation. There is no reason why reform should not one day be extended to direct taxation – such as corporation tax. True, it will take years to bring such issues to the negotiating table. But now that the single currency has been launched, there is a sense among enthusiasts for greater economic integration that everything is possible.

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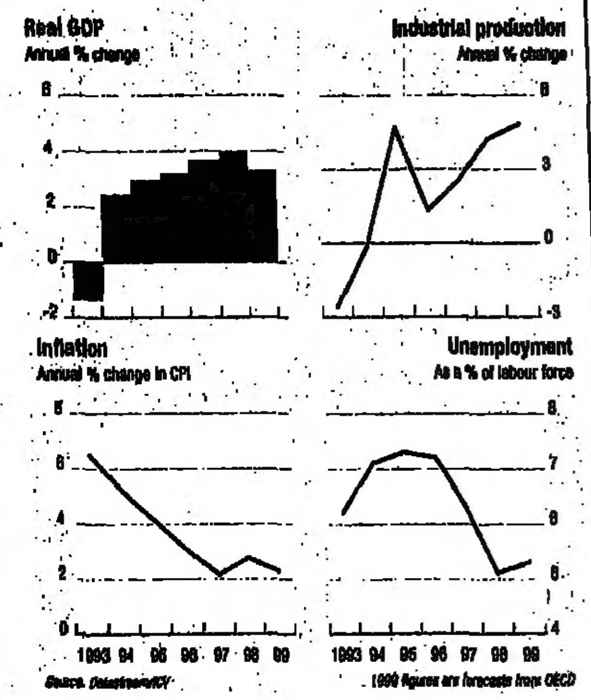
Exemplary, but concerns still remain

Uncertainty behind a tentative start



PORTUGAL by Peter Wise in Lisbon

Inflationary pace forced by election

A 3 per cent pay rise for public sector workers, approved by the Socialist government in January, reflects two of the key issues that are likely to influence the Portuguese economy in 1999 – inflation and a general election.

The wage agreement, considerably higher than pay deals in most other euro-zone countries, was made partly to compensate for the erosion of real wage gains by higher than forecast inflation last year. Unions had agreed to a 2.75 per cent wage increase in 1998 on the basis of a government inflation forecast of 2.0 per cent.

When it became clear that prices would rise substantially above this target – annual average inflation reached 2.8 per cent, the highest level in the euro-zone – António Guterres, the prime minister, promised workers that their lost wage gains would be made up in 1999.

'Substantial reforms . . . are unlikely until after the election'

Such measures were almost inevitable in an election year in which the Socialists will be seeking to win a parliamentary majority – they are currently four seats short. For the same reason, substantial reforms of the social security, tax and pension systems, needed to further fiscal consolidation, are unlikely until after the election.

Portugal surprised many observers with the determination that it brought to disciplining public finances and securing its participation in economic and monetary union. But after seven years of uninterrupted economic growth, often at a pace well above the European Union average, the government's fiscal policies are beginning to look a little unambitious to some economists.

The government's stability programme envisages cutting the public deficit from a forecast 2.0 per cent of gross domestic product in 1998 to 0.8 per cent in 2002. Inflation is forecast to fall to 2.0 per cent this year and remain stable for the next two years. Public debt is projected to fall from 55.5 per cent of GDP to 51.8 per cent over the next four years.

Some analysts believe the country should be moving more quickly towards a zero deficit. But the government's prudence may be advisable as the convergence of interest rates in the euro-zone, the winding down of the privatisation programme and a deceleration in economic growth – from above 4 per cent last year to below 3.5 per cent in 1999, test Portugal's capacity for sustained fiscal discipline.

THE NETHERLANDS by Jeremy Gray

Economy not immune from export shocks

In recent years, the Netherlands has become something of a torch-bearer for reform of Europe's creaking economies. The country's success in taming unemployment – just over 5 per cent – even inspired Germany's Gerhard Schröder, before his election as chancellor, to seek advice from the Dutch.

However, this model economy is proving a poor match for export shocks, notably from south-east Asia and Brazil. According to the Central Planning Bureau, the Dutch government's think tank, the economy will grow just 2.25 per cent in 1999 *owing to the knock-on* effects of a global slowdown. That's down from roughly 3.8 per cent last year, and the CPB estimate has prompted some observers to ponder the abyss.

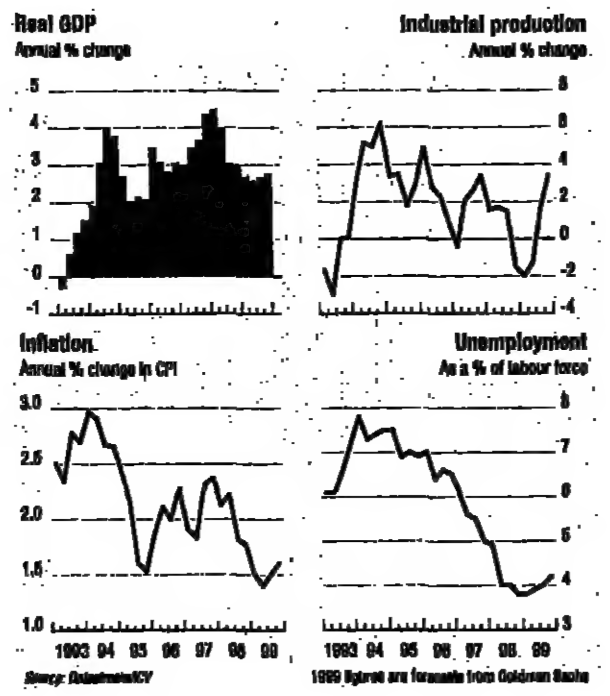
Among the signs of deceleration, Dutch industrial output has been pointed sharply lower. Peter van Doesburg, economist at Effectenbank Stroeve in Amsterdam, says that the sector will probably contract in the current October-March period.

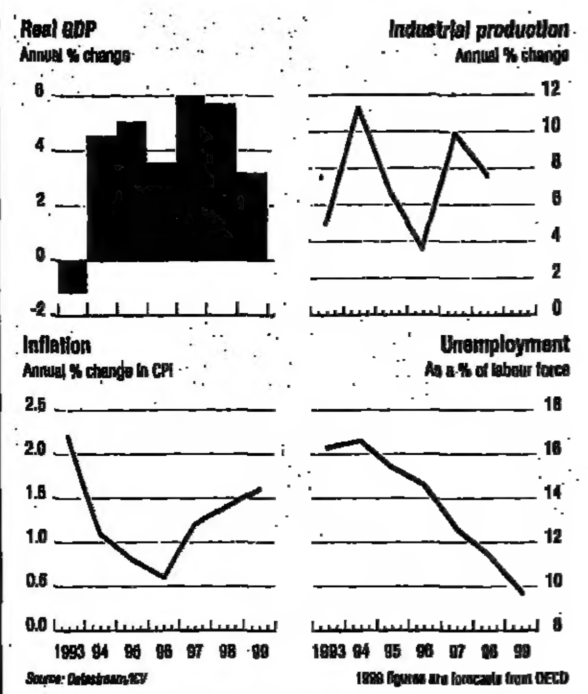
"We have to go back to the recession year 1993 to find two successive quarters of negative growth," the economist says.

Although the chance of a recession is "minimal" (three straight quarters of decline, in a widespread view), the Dutch economy would cool sharply in 1999, Mr Doesburg adds.

Economists believe Dutch exports – about half of gross domestic product – will pick up in 2000, thanks to a cautious recovery in Asia, Russia and Latin America. Yet, consumer spending, the current engine of Dutch growth, will remain weak because of skimpy wage rises and fewer new jobs, according to Bert van den Berg, economist at ABN Amro, who puts GDP growth at 2 per cent in 2000.

The Dutch central bank sees the mini-cycle in reverse, with GDP slumping to 2 per cent in 1999 before climbing to 2.3 per cent the following year. Although far from disastrous, the slowdown raises fiscal questions for Wim Kok, the Dutch prime minister, who has pencilled in annual 2.25 per cent growth to finance the national budgets through 2002.






Unemployment remains high – and a soup kitchen is a result EPA

FINLAND by Tim Burt in Helsinki

Slowdown, but turmoil not likely

Finland has emerged as the sole Nordic representative of the euro zone, and has enjoyed clear benefits from becoming a founder member of the single currency.

In the run-up to the euro launch in January, the Finnmark proved much more stable than currencies elsewhere in the region and bond yields fell.

But Paavo Lipponen, the country's prime minister, is not complacent. Mr Lipponen, who faces a re-election campaign in March, has warned that membership of the single currency has also robbed the country of tools to regulate its own economy.

"Monetary policy, changes in interest rates and the exchange rate cannot be used," he told reporters *recently*, and advocated more flexibility in wage negotiations in Finland.

That may be easier said than done. Unemployment remains high, at around 10.5 per cent, and the country's unions will not be willing to embrace reforms that jeopardise job security.

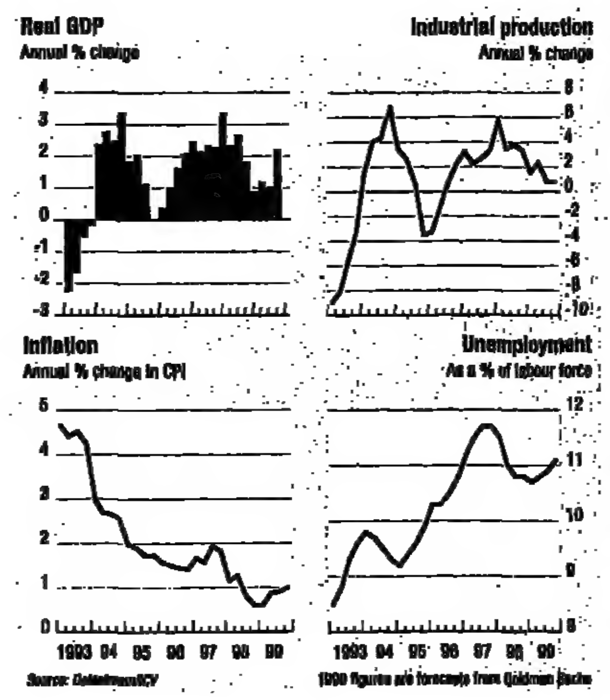
Although domestic demand continues to grow solidly, such jobs could be threatened by falling export demand, particularly in emerging markets.

As Finland relies on Russia and eastern Europe for a large tranche of its international trade, any further downturn there could be painful.

After several years of gross domestic product growth above 4 per cent, some economists are warning that growth could slow dramatically this year to 1.8 per cent, before picking up *by 2.5 per cent in 2000*.

Nevertheless, other indicators point to economic calm rather than turmoil. The general government balance is forecast to show a surplus of 1.1 per cent after years of deficit in 1999, and gross public debt is projected to fall from 51.9 per cent of GDP to 48.5 per cent.

Interest rates are low and consumer demand buoyant. Mr Lipponen, therefore, can take some satisfaction that domestic growth and euro membership should offset the impact of slowing global demand.



GERMANY by Ralph Atkins in Bonn

Resigned to stubborn jobless issue

Germany's economic growth shows all the signs of having faltered significantly late last year. The new Social Democratic-led government of Chancellor Gerhard Schröder is resigned to unemployment remaining stubbornly high in the months ahead. That, in turn, has persuaded Oskar Lafontaine, finance minister, to keep the pressure on the European Central Bank for a cut in interest rates.

Weak figures for industrial production and manufacturing orders, particularly from abroad, have led analysts to conclude gross domestic product may have dipped slightly in the last three months of 1998 compared with the previous quarter. Business confidence has also fallen markedly.

The finance ministry hopes the downturn will prove to have been a "growth dip" limited to the winter months. For 1999, the finance ministry is forecasting a growth rate of 2 per cent, compared with the 2.8 per cent achieved last year. It acknowledges that Germany has been hit by the economic crises in south-east Asia, Russia and elsewhere. But the ministry expects a pick-up in domes*tic demand and the building* industry to partially compensate later in the year.

That could prove optimistic. The Berlin-based German Institute for Economic Research last month revised downwards its 1999 growth forecast from 2 per cent to just 1.4 per cent. It expects exports of goods and services will fall by 1.1 per cent in 1999.

Meanwhile, the formerly communist eastern Germany is still failing to catch up with the more prosperous west, with growth last year rising only a little more than 2 per cent. Although overall German economic growth last year was the fastest since reunification in 1990, there is little prospect of significant inroads being made this year into the country's 4.2m unemployment total.

German workers on the march in demand for jobs AP

BELGIUM by Neil Buckley in Brussels

Finances are now well under control

Belgium's new year began well, with budget minister Herman Van Rompuy announcing that its budget deficit hit a record low in 1998, *while efforts to lighten* its huge debt burden also beat their target.

Reflecting the success of Belgium's efforts to bring public finances under control – primarily to ensure qualification for monetary union – the deficit hit 1.3 per cent of gross domestic product, well below the targeted 1.7 per cent and the previous record of 1.4 per cent in 1966. A similar figure is forecast for 1999.

The debt fell from 121.9 per cent of GDP in 1997 to 116.5 per cent, beating the target of 118 per cent. This year's target is revised down from 115 to 113.8 per cent.

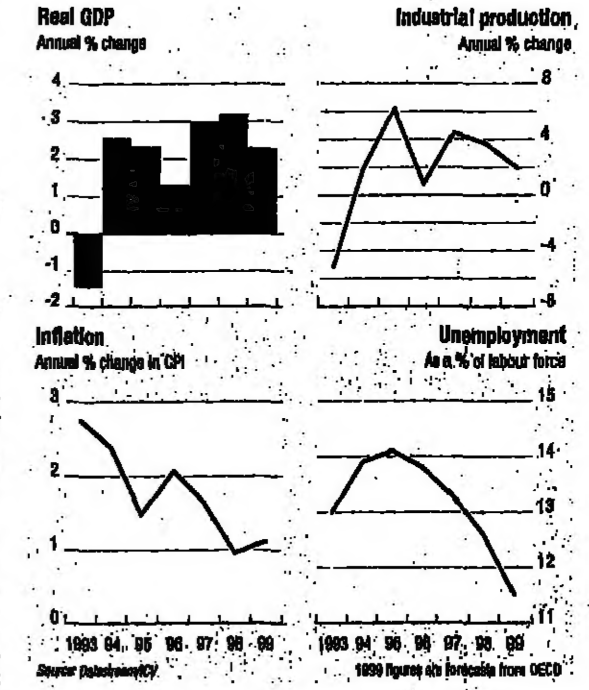
Although growth forecasts have been cut back from 3 per cent to about 2.25 per cent, as the repercussions of the Asian crisis continue, this should be more than *enough to support* the budget projections.

"That growth is still better than the average for Belgium over the past 20 years. It is certainly not a recession," Alfons Verplaetse, Belgian national bank governor, told the FT in a recent interview. He added that consumer confidence remained extremely high, with Belgians showing a reduced propensity to save. Core inflation, at about 1.3 per cent, remained well below problem levels, but there was also no evidence of deflation.

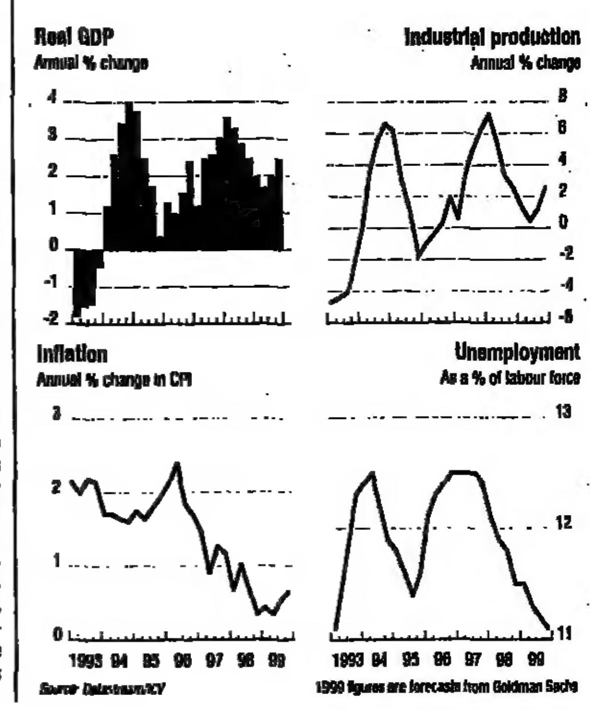
The latest report from the Organisation for Economic Cooperation and Development, published last month, praises Belgium's economic policies. But, it warns, more progress is required in increasing wage flexibility and strengthening incentives to work, with unemployment – *though below the EU average* – still above the OECD average.

It also warns that efforts to control spending should not be at the expense of public investment, which, at only 1.5 per cent of GDP over the past decade, is now among the lowest in the OECD area.

To prevent physical infra*structure deteriorating, the* "quality" of public spending should be improved, with social spending restrained in favour of public investment.




Construction remains the strongest sector in France AP



FRANCE by Robert Graham in Paris

Unrealistic look about growth target

France's robust growth in 1998 has weakened in the new *year as international* financial uncertainties continue and domestic demand levels off.

The less favourable international and domestic climate makes the government's target of 2.7 per cent growth, upon which the 1999 budget is based, look increasingly unrealistic. Private analysts are forecasting within a range of 2 per cent to 2.5 per cent, with the bulk now more inclined to accept the bottom end. Much will depend on whether a flat first half picks up later in the year.

Although French domestic demand is holding up better than that of the other main EU economies, this will be offset by slower-than-expected growth in Germany and *Italy – two key trading partners*. External demand will also be affected by the turndown in the UK, even if this has been well signalled.

Business opinion surveys show inventories returning to more normal levels and a clear downgrading of expectations. This less buoyant mood set in during the last quarter of 1998. The stron*gest sector continues to be* construction with new housing starts stimulated by low interest rates and tax incentives.

Public works activity is also at the highest levels in a decade. Household consumption has benefited from a 3 per cent increase in purchasing power. This has been especially noticeable in the purchase of new cars.

The slowing down raises questions over the continued trend of falling unemployment evident throughout 1998. By December, the jobless rate had dropped to 11.6 per cent from 12.3 per cent of the workforce. The bulk of new jobs are being created in the service sector, and are often temporary.

With the Socialist-led *Jospin government committed* to reducing unemployment, it is liable to take action to sustain growth if the figures look too negative after the first quarter. Any stimulus to underpin growth would be taken against the background of near zero inflation.

FOREIGN EXCHANGE by Alan Beattie

Uncertainty behind a tentative start

Only after several weeks of trading did the attention of the foreign exchange markets turn to the euro as a currency rather than to the technical difficulties of its launch.

The trading systems have bedded down, after some embarrassing glitches in euro-zone money markets in the first couple of weeks as Target, the pan-European settlements system, jammed and some payments went awry.

As for the foreign exchange industry itself, it has had little more adjustment to make.

The introduction of the new currency was one of the more predictable shocks to hit the industry. Once it became clear that a critical mass of EU countries would enter monetary union, much of the business involved in trading their currencies disappeared as they stayed fixed to their conversion rates and speculation to the contrary dried up.

So most banks involved in the currency markets had made the necessary adjustments to their trading floors months or years before the currency was actually launched.

The main issue left to be resolved now is the form the new currency will take. So analysts are watching the euro's daily movements carefully.

Few are yet prepared to risk drawing conclusions from the euro's performance, since, with the market this year so far dominated by the threat of more emerging market turmoil and by the wild gyrations of the yen against the dollar, the euro has had to take a back seat.

In fact, so far the euro has behaved against the dollar rather as the D-Mark used to. Interest rate expectations falling in the euro-zone and rising in the US have driven the currency lower. From a launch value of around $1.16, the euro had declined to around $1.12 by early February.

Euro bulls – those who expect the currency to rise – have pushed their expectations of euro strength further into the future. But few have changed their minds on the euro's long-term prospects.

Enthusiasts for the euro think it could eventually challenge the dollar for the role of main international reserve currency, serving as the default option for trading and pricing around the globe.

With capital markets widening and deepening in the euro-zone, and the US mired in problems with its Latin American backyard and a yawning current account deficit, the euro has a chance to seize the initiative, they say.

Reserve currency status has some advantages. If a large part of international trade is denominated in euros, it removes the cost of buying foreign exchange, or hedging against movements in currencies, for euro-zone companies trading internationally.

The sheer size of the euro-zone is a huge advantage when it comes to promoting a currency as the international standard. However impeccable a country's anti-inflationary sound money credentials, its currency is unlikely to become an international reserve unless a great deal of business is transacted in that medium because of the size of the underlying economy.

"The Swiss franc is a legendarily hard currency," said one analyst. "But because it is not as easy to buy and sell Swiss francs as it is dollars, because of the relative sizes of the two currencies, it has not achieved reserve status."

'Enthusiasts for the euro think it could challenge the dollar for the role of main international reserve currency'

In a research note published last year, the US bank, J. P. Morgan, says that there is a direct correlation between the amount of any particular currency held by the world's central banks and the share of global trade invoiced in that currency. But the causation went from trade to holdings, not the other way round.

"Reserve currency status is bestowed by the markets, not by central banks," the note said. "And since Europe is a big economy and a big exporter, the high liquidity and low transactions cost of the euro will mean that the market adopts it as a vehicle currency."

It estimates that even a relatively modest increase in the euro's share of central bank reserves, from a current 22 per cent to 35 per cent, could see a shift of nearly $200bn into euro-denominated assets, boosting the currency.

But some are less optimistic on the prospects for the euro. They argue that much of the shift in central bank reserves may already have taken place, and may in any case be offset by European central banks needing to diversify out of euros.

"Our sources suggest that buying of euros by central banks in 1998, especially in east Asia, was larger than many imagined," says Ray Attrill, of the economic consultancy, 4Cast, in London. "This may help explain the weakness of the dollar at the end of last year," he says.

Mr Attrill adds that the European central banks in the euro-zone now have some $35bn-45bn worth of euros in their portfolios from cross-holdings in the legacy currencies which entered the euro. "These holdings, which were mainly in D-Marks, are now useless as reserves," he says. "And if I were a central banker I would convert them into dollars as soon as possible before finance ministers start eyeing them up as a source of revenue," he adds.

Other market participants have more deep-seated and fundamental objections to the euro in its first year, pointing to the structural weaknesses in the European economy.

"Until recently a lot of people were saying that rising yields in European assets would lead to strengthening of the euro against the dollar," says Michael Rosenberg, manager of international fixed income research at Merrill Lynch in New York. "But it has become clear that the optimistic forecasts of European growth are misplaced and that it will not outstrip the US economy this year."

Mr Rosenberg adds that far from strengthening against the dollar, he expects the euro to continue to weaken. "There is a strong correlation between the performance of the dollar against the D-Mark and the relative yield on US and German assets," he says. "By that reckoning, given the recent widening of spreads the dollar has a degree of catching up to do." Mr Rosenberg expects the euro to weaken to around $1.06 against the dollar over the next 12 months from its current level around $1.12.

But although preliminary indications are that the euro will disappoint those who expect a rapid rise in the new currency, caution and risk-aversion are the dominant factors in the currency markets at the moment. This means that optimists and pessimists will have to wait for their predictions of the euro's nature to be vindicated. For the moment, uncertainty rules.

BONDS by Edward Luce

Banks gambling on market growth

The world's leading investment banks have gambled heavily on the premise that monetary union will lead to an explosion in the size of Europe's bond market. Forests have disappeared in the scramble to bring out reports on the subject. Few – if any – topics have excited the appetite of bankers so vividly. From Merrill Lynch to Barclays Capital, investment banks have been hiring at an unprecedented rate.

Just two years ago, the markets were worried about job losses in foreign exchange trading which would result from the abolition of 11 currencies. Those have been dwarfed by the number of new hires in areas such as credit research, corporate bonds, asset backed securities, high-yield debt and leveraged finance. Thus, banks have staked a great deal on the expectation that Europe will rapidly come to resemble the US in the size and shape of its debt markets.

Is this a realistic proposition? The answer depends on the speed of growth which is needed to justify the costs which have already been sunk. And the picture will vary from bank to bank. But it is safe to say that all banks, to varying degrees, have gambled on the unprecedented growth of Europe's corporate and high-yield bond markets.

This optimism is grounded on three propositions.

First, investors will be on the look-out for new types of asset having been deprived of their staple diet of European currencies. Investing in European government bonds will no longer yield the returns to which they are accustomed, owing to the fact that most of the gains were derived from currency movements. This will (and, to an extent already has) stimulate new appetite for riskier, but higher-yielding, instruments such as corporate bonds and emerging market debt. As the jargon goes, investors will start to "move down the credit curve".

Second, the creation of a genuinely single market will deprive companies and banks of the cosy domestic relationships on which they have relied for their mainstream business. The emergence of a single European stock market will intensify the restructuring of European industry and the promotion of shareholder value.

Corporate bond markets thrive on lively equity markets. Banks will no longer so readily provide low-margin straight loans to their client companies, and their clients, in turn, will want to exploit the price advantages and lengthier maturities on offer from a continental pool of private savings. The development of a more explicit shareholder culture will therefore force both banks and companies to seek cheaper and more liquid sources of capital. Again, as the jargon goes, the launch of the euro will intensify the "disintermediation" of Europe's banking sector.

And third, the launch of the euro will lead to a shake-up of Europe's traditional and emerging industries. Mergers, acquisitions and even hostile takeovers will become commonplace in this more competitive environment. New companies will emerge, old companies will be gobbled up and everyone will be in the market for risk finance. Leveraged finance and other American specialities such as high-yield bonds will take-off.

To a certain extent, much of this optimism has already been borne out. From a volume of zero in 1996, Europe's junk bond market is now approaching $10bn (€8.7bn) in outstanding volume while the mainstream investment grade corporate bond market is also growing strongly. In light of the dramatic closure of the eurobond markets last year, the volume of non-government bond issuance appears even more impressive. Companies such as Olivetti, Lafarge, Carrefour and Porsche have tapped bonds for the first time. And banks, including Deutsche Bank and Santander, have sought to improve their return on capital with innovative asset-backed offerings secured against future income streams from loan and mortgage repayments.

Similarly, investors have geared up well for the change. The total amount of capital raised for leveraged and management buy-outs in Europe has exceeded $20bn from less than $10bn a year ago, with houses such as Cinven, Doughty Hanson and Hicks, Muse leading the way. A number of European asset managers, including Mercury Asset Management and Robert Fleming, have launched dedicated high-yield bond funds for Europe which have proved popular with investors.

'Debt markets are taking on the characteristics of the US'

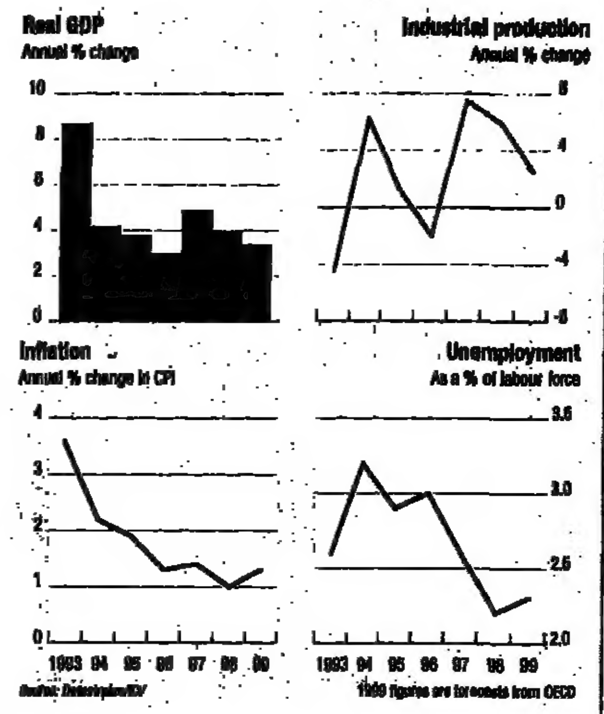
Moody's Investors Service and Standard & Poor's, the credit rating agencies, report that the number of corporate ratings in Europe has doubled over the last two years and is set to increase at a similar rate in the next two.

There is therefore little doubt that Europe's debt markets are taking on the characteristics of the US. But there are also reasons for believing that growth will be steady rather than dramatic. One key difference between the US and Europe is the level of private savings. Apart from the UK, which remains outside the euro-zone, and the Netherlands, European countries still have minuscule private pension funds in comparison to the US. Until governments move from "pay-as-you-go" pensions to funding benefits, demand for a high-volume bond market is likely to be constrained.

One other possible constraint is the lack of an indigenous venture capitalist industry in continental Europe. In spite of the growth of mostly US leveraged funds in the last 12 months, there is still barely any continental European venture capital or leveraged buyout capacity. This could also act as a break on the rapid development of Europe's bond markets.

LUXEMBOURG by Neil Buckley

Exemplary, but concerns still remain



Luxembourg swapped membership of one monetary union – its 78-year-old economic union with Belgium – at the start of this year for another: European monetary union.

The fact that the 400,000-strong Grand Duchy has a seat at the table of the European Central Bank alongside countries more than 100 times its size is partly an accident of history, but also reflects Luxembourg's continuing exemplary success in running its economy.

Growth is forecast to slow slightly this year but remain at a healthy 3.5-3.7 per cent, after 4 per cent last year, and 4.8 per cent in 1997.

Unemployment is also expected to continue to fall below the already low level it reached last year, as Luxembourg continues to create jobs at an impressive rate. Salaried employment grew 4.4 per cent in the first half of last year, with the number of employed residents up 2.2 per cent, and the number of "frontaliers" – or employees travelling in from neighbouring France, Germany and Belgium – up 9.5 per cent.

Inflationary pressures remain almost non-existent.

Much of Luxembourg's success stems from its efforts to diversify its economy into new growth areas, such as banking and finance, and the media. But the latest report from the Organisation for Economic Co-operation and Development, published last month, repeats earlier warnings that the Grand Duchy cannot rely totally on diversification.

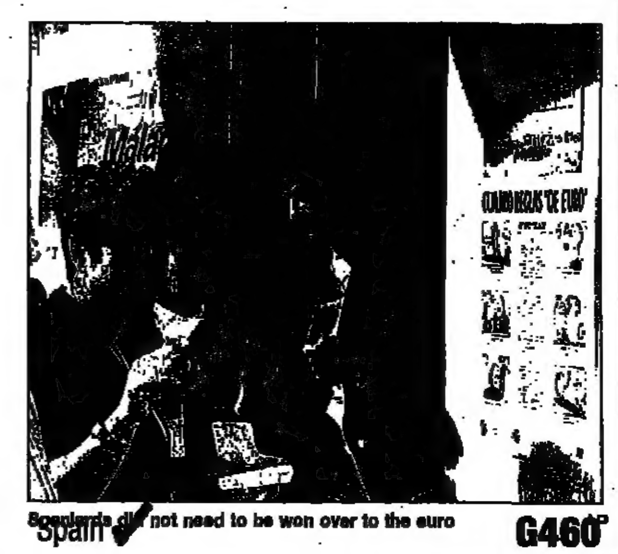
It warns that Luxembourg's financial market could be threatened by moves to curtail banking secrecy, and EU minimum withholding tax proposals.

It also says more structural reform is needed to increase Luxembourg's competitiveness and labour force participation by improving training and removing labour market rigidities.

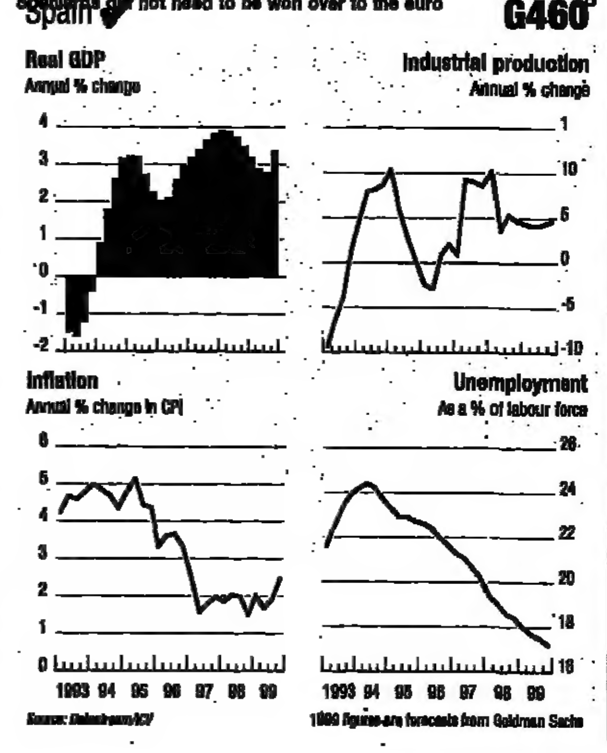
Finally, despite reforms undertaken by the government – well in advance of some other EU countries – concerns remain over Luxembourg's state-funded pensions. The OECD says Luxembourg needs to improve management of financial services and create a funded complementary pension to avoid the risk of a pensions time bomb next century.

SPAIN by David White in Madrid

Euro at root of economic confidence



Spaniards did not need to be won over to the euro



The most expensive TV commercial slot on Spain's main state network – just before the stroke of midnight on New Year's Eve – was taken this time not by a drinks or car manufacturer but by the finance ministry, promoting the euro.

But Spaniards did not need winning over. The single currency already displayed its benefits before its introduction, strengthening economic confidence. The imposed discipline of convergence, far from painful, has so proved a miracle treatment.

For Spain, monetary union could hardly have begun in more propitious circumstances – a mood of economic optimism and a growth rate unmatched in any of its larger European Union partners, with inflation at its lowest since current statistics began in 1962.

Cristóbal Montoro, state secretary for the economy, says this growth cycle is of a different kind from previous booms, which generated imbalances.

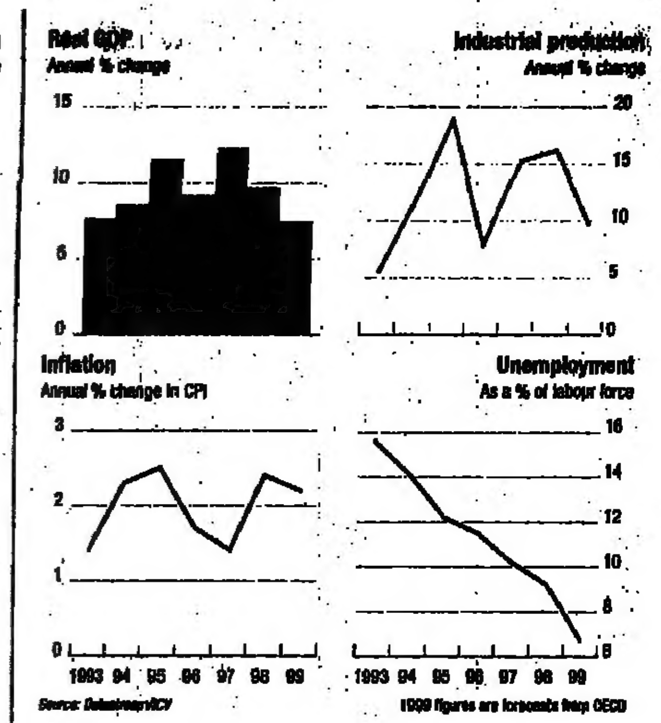
He believes Spain can keep growing at close to 1 percentage point above the EU average. This would not be a spurt like Ireland's recent performance – "an economy the size of Spain's cannot behave that differently" – but he hopes it can spawn enough jobs to bring unemployment more into line with other EU countries.

The official jobless rate, which experts agree is overstated, still runs at more than 18 per cent. The centre-right government foresees 1.3m new jobs being created in the next four years, after a 450,000 increase last year. That, it reckons, would cut unemployment to 13 per cent.

The Spanish stability plan submitted to Brussels envisages annual growth around 3.3 per cent in the early 2000s, against the current 3.8 per cent, with inflation staying below 2 per cent following last year's 1.4 per cent. Unlike Germany, France or Italy, Spain aims to wipe out its budget deficit entirely by 2002, if growth matches expectations. It is, Mr Montoro says, the most ambitious plan in the euro zone, but "not over-pretentious".

IRELAND by John Murray Brown in Dublin

Sanguine about being out of step



Ireland, as the fastest growing economy in the European Union, is out of step with other members of the single currency. With interest rates at historic lows, some economists are concerned this could fuel consumer spending, add fire to an already booming housing sector, resulting in higher inflation which could damage the economy's competitiveness.

Officials remain sanguine. They point to the benign demographic picture, with Ireland enjoying a growing workforce as emigrants return home and more women take jobs. Combined with the low 10 per cent corporate taxes for manufacturing, this has been the main lure for foreign investors, who are locating in Ireland in record numbers.

'The government is looking at ways to encourage more employee profit sharing'

As a result, unemployment, while still above EU norms, is coming down. However the economy is now experiencing the first signs of skills shortages – in the software and construction sectors.

On the housing front, the government introduced tax changes last year in a bid to reduce the amount of speculative buying by investors in the property market. However, prices still grew by more than 40 per cent in 1998 in the Dublin area, and close to 20 per cent across the country.

To keep the lid on the economy, much will depend on the next round of wage negotiations which are due to get under way later this year between government, business, farmers and the unions.

Under the current three-year social pact, workers agreed to wage moderation in exchange for tax cuts, with wage increases kept to around 2 per cent. The one exception is the public sector, where recent settlements with the police have triggered a spate of claims from teachers and nurses.

In the upcoming negotiations, unions will be pressing for greater union recognition, particularly among the largely non-unionised, foreign-owned multinational sector which drives the economy. The government, for its part, is looking at ways to encourage more employee profit sharing as a way to compensate workers.

But a strong euro, coupled with the prospects of a world economic slow down, will probably do more to see off the threat of over-heating than any tweaking of the economic levers by the Irish finance ministry.

It's

Recession hovers in

Three-year effort gives smooth start

Forecasts of the European Commission from October 1998

	1997	1998	1999	2000
GDP	2.5	3	2.6	2.9
Consumers Expenditure	1.4	2.5	2.7	2.5
Government Consumption	0.5	1.6	1.7	1.6
Total Fixed Investment	2.1	4.1	4.8	5.5
Stockbuilding (1)	0.6	0.5	0	0
Final Domestic Demand	2	3.2	2.9	3
Exports of goods and services	9.8	7.1	4.9	6.2
Imports of goods and services	8.7	7.9	6	6.4
Net trade (1)	0.6	-0.1	-0.3	0
Nominal GDP growth	2.3	4.1	4.8	4.8
GDP deflator	1.5	1.6	1.9	1.9
Compensation per employee	2.5	1.8	2.7	2.6
Unit Labour Costs	0.2	-0.2	1.1	0.9
Total Employment	0.2	1.1	1	1
Manufacturing Employment	-0.6	1	0.9	0.9
Unemployment Rate (2)	11.6	11	10.4	9.9
Overseas sector				
Export Volume	10.2	7.5	4.8	6.2
Import Volumes	9	8.3	6.1	6.6
Trade Balance ($bn)	175	193	211.4	220.3
Current Account ($bn)	106.1	122.3	134.4	139.1
Current Account (3)	1.7	1.9	1.9	1.8
Public sector (3)				
Government Expenditure (3)	49.7	49.1	48.5	47.9
Government Receipts (3)	47.3	46.7	46.6	46.2
Government deficit (3)	-2.5	-2.3	-1.9	-1.7
Public Debt (3)	75	73.8	72.6	70.9

Forecasts of the OECD November 1998

	1997	1998	1999	2000
GDP	2.6	2.9	2.3	2.7
Consumers Expenditure	1.5	2.4	2.3	2.6
Government Consumption	0.2	1.3	1.4	1.4
Total Fixed Investment	1.9	4.4	4.3	4.5
Stockbuilding (1)	0.6	0.5	0	-0.1
Total Domestic Demand	2	3	2.8	2.7
Exports of goods and services	11.1	6.3	4.4	6.3
Imports of goods and services	8.8	8	5.8	6
Net trade (1)	0.6	0	-0.1	0.1
GDP deflator	1.4	1.6	1.5	1.6
Compensation per employee	2	1.7	2.5	2.8
Unit labour Costs	0.1	0.2	1.2	1.3
Unemployment Rate (2)	12.4	11.7	11.3	10.8
Employment growth	0.4	1.1	1	1
Overseas sector				
Trade balance ($ bn)	176	201	217	222
Current Account ($ bn)	107	125	140	146
Current Account (3)	1.7	1.9	2	2

Economic forecasts for the euro-zone

While strict comparisons between different sets of euro-zone economic statistics may not be possible because of the slightly different time-frames represented, it is interesting to *note the moving trends that emerge and some of the clear* differences of opinion. Presented below are four sets of aggregate forecasts for the European economic area. The first E11 figures are from the European Commision and now form part of its regular spring and autumn forecasts for the whole of the EU. These were published in October. The next set of figures is from the OECD Economic Outlook which was published in December 1998. The third set is from the UK's National Institute of Economic and Social Research (NIESR) and was published in January 1999. The final set of forecasts is from Goldman Sachs and was published as part of its January/February European Economic Analyst. By presenting the four sets of figures, readers can compare the views of these institutions. It is worth noting that as member countries release statistics the aggregate forecasts will change, and this is what precludes strict comparability between the forecasts: later versions have more 1998 data available to them than those which were produced earlier.

The later forecasts are not as optimistic as the earlier ones about prospects for growth in the European economic area this year and next. However, inflationary pressures remain weak in all the forecasts. Goldman Sachs and the NIESR both predict inflation as low as 1 per cent this year. For interest rates, the OECD, NIESR and Goldman Sachs all forecast further falls in short term rates. All the forecasters predict further modest falls in unemployment during this year, but opinion differs over what will happen the following year. For 1999, the European Commission forecasts a further fall to below 10 per cent, but Goldman Sachs forecasts a slight upturn, which would take the unemployment rate back to a disappointing 11 per cent.

Forecasts of the OECD November 1998 (continued)

	1997	1998	1999	2000
Financial sector				
Short term interest rates	4.2	3.8	3	3.1
Long term interest rates	5.9	4.7	4.2	4.3
Public sector				
Government Expenditure (3)	49.3	48.7	48.3	47.8
Government Receipts (3)	46.8	46.4	46.3	46.2
Budget deficit (3)	-2.5	-2.3	-1.9	-1.6
Public debt (3)	75.2	73.9	73.1	72.1

NIESR forecasts from November 1998

	1997	1998	1999	2000
GDP	2.5	2.9	2.2	2.4
Domestic Demand	2.1	3.2	2.4	2.5
Net trade (1)	0.4	-0.3	-0.2	-0.1
Consumer prices	1.6	1.2	1	1.4
GDP deflator	1.6	1.4	1.2	1.6
Unemployment Rate (2)	11.7	10.9	10.5	10.3
Current Account (3)	1.8	1.8	2.1	1.5
Short term interest rates	4.2	3.8	3	3
Budget deficit (3)	-2.5	-2.1	-1.6	-1.4
Public debt (3)	75.1	74.1	72.7	71

Goldman Sachs forecasts January 1999

	1997	1998	1999	2000
GDP	2.5	2.9	1.9	1.9
Consumers Expenditure	1.6	2.8	2.5	2.2
Government Consumption	0.2	1	1.2	1.2
Total Fixed Investment	1.7	3.4	4	2.8
Stockbuilding (1)	0.7	0.6	-0.3	-0.2
Total Domestic Demand	2.1	3.1	2.2	2
Exports of goods and services	9.8	6	3.2	3.8
Imports of goods and services	8.8	7.3	4.6	4.3
Net trade (1)	0.5	-0.1	-0.2	-0.1
Output and Prices				
Industrial production	3.9	4.2	1.7	2.6
Producer prices	0.9	-0.4	-0.8	1.5
Consumer prices	1.6	1.2	1	1
GDP deflator	1.4	1.4	1	1.1
Wages per employee	2.6	1.8	2.3	1.8
Output per employee	2.3	1.8	1	1.2
Unit labour Costs	0.2	-0.1	1.3	0.6
Nominal GDP	3.6	4.3	3	2.9
Labour Market				
Unemployment Rate (2)	11.7	11.1	10.9	11
Employment growth	0.1	1.1	0.9	0.6
Overseas sector				
Trade balance $bn	178.8	198.1	199.1	198.4
Current Account $bn	112.5	108.2	97.5	80.9
Current Account (3)	1.7	1.5	1.2	1.1
Financial sector				
Short term interest rates	4.2	3.2	2.7	2.7
Long term interest rates	5.4	3.9	3.8	3.8
Public sector				
Budget deficit (3)	2.4	2.2	2.3	2.3
Public debt (3)	74.8	73.8	73.8	73.9

All figures are annual percent changes except where otherwise stated
(1) applies to Stock building and to Net Trade Contribution to change in GDP.
(2) applies to the unemployment Rate Percentage of labour force.
(3) applies to the Current Account and Public sector figures Percentage of GDP

COMMENTARY by Nicholas Leslie

Upbeat at prospect of stability

This is the first commentary of the Pink Book focus group. The aim is to provide a regular review of corporate economic activity based on the responses of a focus group of companies in all 11 member states of the euro-zone. It will deliver a comparative and essentially anecdotal snapshot of *demand, labour, stock levels*, exports, financial and other needs. Over time, trends will emerge. The commentary will broaden as the focus group membership increases. Companies interested in joining the group are invited to contact the editor of the Pink Book (see footnote).

Europe's companies are confident benefits will flow from the greater stability offered by Emu and the single currency. This theme clearly emerges from reports of the initial members of a focus group of companies for the FT Review of the European Economy – the Pink Book. For those enjoying the prospect of expanding markets – such as technology and some consumer and leisure sectors – this stability is expected to be particularly valuable. And even in more mature, heavy industry facing intense competition in difficult markets the euro is seen *as offering a measure of* advantage over, for example, UK competitors. As one company remarked: "The present high level of the pound against the euro makes the group stronger in comparison with one of its main competitors in Britain."

The worsening economic climate in the euro-zone is reflected in companies' responses to questions about staff levels, prices, inventories and investment plans. And enthusiasm for the euro and low interest rates is tempered by worries about the euro-zone economy which appear to be acting as a constraint on some investment and expansion ambitions. One banking respondent's view is that "while the low interest rates have a positive impact on investments and, consequently, positive implications for the lending sector, the negative expectations of the corporate sector are having a dampening effect on demand for credit". On the other hand, though, most focus group members intend, despite a more difficult climate, to continue with their investment programmes.

'Enthusiasm for the euro and low interest rates is tempered by worries about the euro-zone economy'

Workforces – which have already been cut over the past year – will continue to contract, some significantly. Leisure, tourism and technology sectors may provide exceptions, but heavier industry, utilities and the energy and financial sectors in several regions are set to continue the trend of reducing staffing levels in their drive for efficiencies and cost cuts.

Inventories also figure in the drive for economies. One, rapidly-expanding technology-based company in the focus group has allowed inventory levels to rise just a little over the past year, but others have been cutting back and there is a more general expectation that in the coming year inventory levels will be pruned, or at least contained. Interestingly, even one of the technology companies which has ambitious growth targets for the current year is looking to achieve this without allowing inventories to rise above 1998 levels.

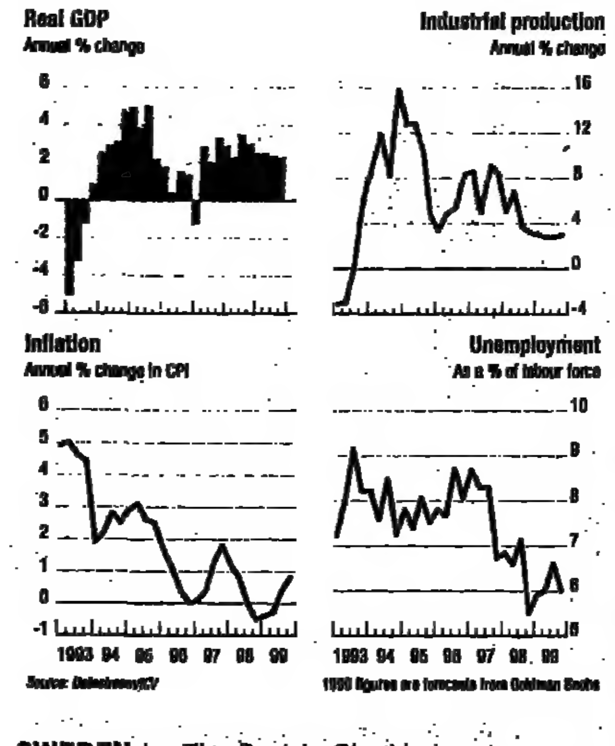
Margins are reported to have been under pressure across a number of sectors, and this is expected to continue in the current year. One company reports that "both domestic and export prices have significantly dropped over the past 12 months", but *it is slightly* more optimistic about the second half of 1999 when "prices could again show a positive slope".

For some, there may be factors to compensate for margin pressure. For example, the looming pensions question in the euro-zone looks like presenting an opportunity. One financial company points out that "due to public discussion about provisions for old age, the growing attractiveness of private pension insurance offers a major opportunity of expansion in the life insurance business".

Elsewhere, a belief was expressed that "the instability of financial markets is expected to determine lower margins in private banking and asset management . . . however, the growth of revenues will be guaranteed by the growth of volumes".

The balance of opinion on the euro at this early stage is that it will eventually emerge as a strong currency. One company, for which the euro/US$ exchange rate is "very important" because of the dominance of the dollar in its markets, believes the likelihood is high that the euro will appreciate slightly against the dollar, sterling and the yen. Others feel that "the current euro exchange rate is quite competitive", and that the "euro/$ rate and sterling/dollar rate are less favourable".

(Companies wishing to participate in the focus group should contact the editor of the Pink Book: Tel: 44-171 873 4157; Fax: 44-171-873 3197; email: nick.leslie@ft.com)



Source: Datastream/ICV
1999 figures are forecasts from Goldman Sachs

SWEDEN by Tim Burt in Stockholm

Reassessing attitude to euro-zone

When the Swedish government published its 1999 economic forecasts last autumn, most international economists regarded its growth forecasts of 3 per cent this year and 3.2 per cent in 2000 as absurdly optimistic.

Faced with a marked slowdown in export demand, the government was forced to revise its forecasts downward to 2.8 per cent this year and 3.2 per cent next. Even that may be too high and some observers believe the true rate will be closer to 1.7 per cent and 2.4 per cent in 1999 and 2000.

The revision reflects Sweden's over-dependence on export industries and markets – particularly in Asia and Latin America – where the call for Swedish industrial and investment products has fallen sharply.

'Export slowdown should be offset by buoyant domestic demand'

Of the country's gross domestic product, some 40 per cent is export related and any signs of an international slowdown has an exaggerated impact on the Swedish economy, forcing companies to cut production and lay off workers.

In recent weeks, for example, the telecommunications giant Ericsson has announced plans to cull 11,000 jobs – 30 per cent of them in Sweden – while the newly-merged paper group, StoraEnso, said it would cut 2,000 staff, or 5 per cent of the workforce.

That all sounds grim. However, the export slowdown should be offset by buoyant domestic consumer demand, low interest rates and nominal inflation.

Possible tax reforms to abolish anomalies such as double dividend taxation and wealth tax could further encourage domestic demand.

"On balance, the domestic recovery is expected to keep Sweden's growth on a par with the euro area average," according to analysts at J.P. Morgan, the US investment bank.

The twin pressures of sagging export growth and robust demand at home have encouraged the government to reassess its attitude to euro membership. Sweden has watched enviously as the euro-zone economies have withstood the worst of the recent international stock market turmoil and export-demand volatility.

Senior politicians are now signalling that a referendum could be held before Sweden assumes the EU presidency in 2001, paving the way for euro membership at the start of 2002. If so, it could signal that Scandinavia's largest economy is ready to come in from the cold.

GREECE by Kerin Hope in Athens

Inflation squeeze key to entry

The bid by Greece to join the euro on January 1 2001 is gaining credibility as the inflation rate moves steadily down. Yearly inflation shrank to 3.9 per cent in December, the lowest level for almost 30 years, as the effects of tax cuts and a price freeze agreed with wholesalers kicked in.

Provided the socialist government can squeeze yearly inflation below 2 per cent by December, the chances are that the European Commission will give the go ahead next spring for Greece to enter the euro-zone.

It was the only EU member state to be involuntarily excluded from the launch of the single currency, because of failing to meet any of the Mastricht convergence criteria. However, tight fiscal policies are producing results. Last year's budget deficit is estimated at 2.2 per cent of gross domestic product, comfortably below the 3 per cent of GDP convergence ceiling.

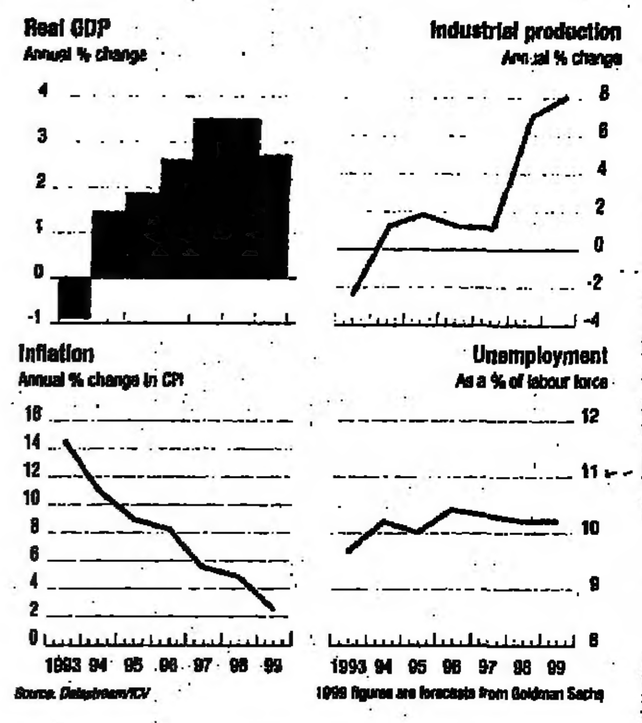
The public debt, though still well outside the target, declined by four percentage points to 105.5 percent of GDP.

"Failure to join Emu is simply not on the government agenda," said Yannis Stournaras, chief adviser at the economy ministry.

He believes Greece will continue to enjoy growth rates above the EU average. The economy is set to grow this year by 3.7 per cent, compared with 3.5 per last year.

Rising public investment as Greece races to meet deadlines for drawing down EU funds from the current structural aid package, and a surge in productivity in the private sector, would help offset the effects of a slowdown elsewhere in the EU, the members of which are Greece's main trading partners.

The business climate has rarely been more optimistic. But it will take time to reduce unemployment below the current rate of 10 per cent. Until recently, increased demand for skilled workers in the fast growing services sector was matched by job losses that resulted from closures of inefficient manufacturing companies.



Source: Datastream/ICV
1999 figures are forecasts from Goldman Sachs

CASE STUDY
BOOTS

Real mountain yet to be climbed

Imagine the customer from euro-hell.

"He wants to pay in a combination of euros and sterling, and needs to know how the till has arrived at the conversion price. But he wants all of his change in sterling and by the way he has a few gift vouchers as well," says Roger Williams, euro programme manager for Boots, the UK chemists chain.

Boots has spent two years preparing for that customer and believes that, by January 1 1999, it was ready for every challenge he could present.

In fact, since E-day, almost no one has tried to make use of the limited euro facilities available, not even the company's biggest and most global suppliers. "So far, we are not seeing huge volumes of people wanting to trade in euros," he says.

But that does not mean efforts have been wasted. "Customers are starting to ask questions," Mr Williams says.

Boots has three main divisions, each of which operates in countries which have signed up to the first wave of monetary union. The manufacturing and marketing arms, which make and distribute toiletries and over-the-counter medicaments, operate in nine euro countries. The retail business has a presence in two – Ireland and the Netherlands. Last month the group announced plans to spend almost £50m expanding in the Dutch market.

Boots set up a team of project managers in 1997 to take its business apart in the search for areas which might be affected by a single currency.

The questions they were asked to address were what did they *have* to do to prepare for a single currency, and what was discretionary. What were the operational and strategic issues, how prepared were suppliers and where were the business opportunities. These last, says Mr Williams were "rather hard to find".

In the end, however, the teams decided the single currency would have a significant and far-reaching impact. "The changes are truly cross-functional and there are few areas of Boots that will remain untouched," Mr Williams says.

The group has had to change its accounting and purchasing systems to deal with a new currency and prepare for an altered relationship with suppliers and customers. To a certain extent, the task was made easier by the fact that system upgrades were already complete or in progress for both the retail and manufacturing businesses.

"The shop tills were already able to handle foreign exchange so we did not need to do much work on them. The work had been done in the 1980s," Mr Williams says.

For manufacturing, only one additional change was required to the upgrade scheme already in place. As a result, the costs have been estimated at a modest £5m.

But, as far as Boots is concerned, the real mountain is still to be climbed. As 2002 approaches, when notes and coins will be introduced, the group will have to begin training its staff. They will be at the front line, expected to educate consumers who will often be confused and almost certainly suspicious.

Training will account for at least half the estimated £40m costs if the UK joins.

Moreover, with a relatively low average transaction value, Boots will be more exposed to taking the old currency out of the system than retailers whose customers tend to pay for higher priced products with credits cards or cheques.

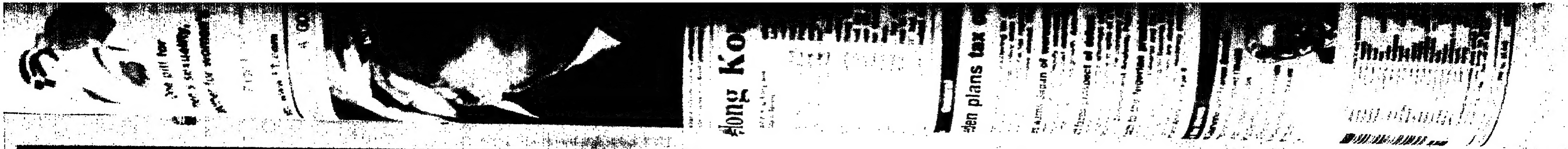
In addition, the introduction of the euro notes and coins will almost certainly affect business in Boots' home market, even if the UK does not join, Mr Williams believes. For example, if there are a significant number of tourists into the UK then airport shops have to be able to take euros and staff have to be trained. So systems and planning have already been done for the UK business.

The manufacturing arm may also have to alter packaging and specifications for Boots' own-brand products, a change which could leak back into the UK, if conversion to a new currency results in new price points in the euro-zone.

For example, simply converting a product priced at £2.50 into euros could leave customers feeling that it has become more expensive. Retailers may be forced to round prices down, but will have to alter the product specification to maintain the margin.

Mr Williams says Boots is as ready as it should be at this stage. And while there has not yet been much demand to put Boots to the test, he believes this is only a temporary lull. "More people will want to deal with us in euros," he says. "We are looking to be operating internally as a euro company."

Peggy Hollinger



ITALY by James Blitz in Rome

Low growth puts budget target at risk

Italy shows no sign of deviating from the tight control of its public finances that was required to get the country admitted to the euro. But some economists continue to be preoccupied by Italy's low growth rate, amid fears that lower tax receipts are making it marginally harder for the country to meet its budget targets.

The country should post a budget deficit for 1998 which is between 2.6 and 2.7 per cent of gross domestic product, slightly above the target set out by the Treasury last April.

Although this is due to the impact of lower-than-expected growth in 1998 (expected to come in at around 1.5 per cent), this budget deficit figure would still be within the terms allowed by the Maastricht treaty.

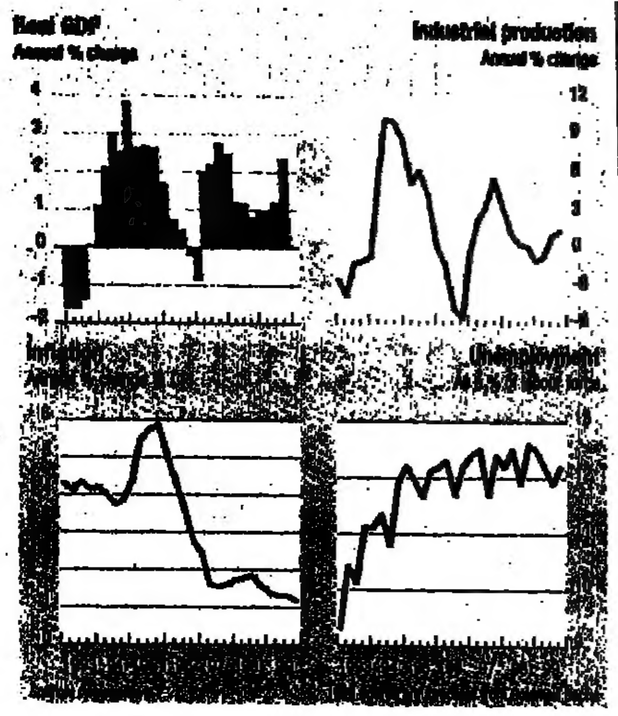
The government is also expected to reaffirm its pledge to reduce further the budget deficit and debt in a three- or possibly four-year plan to be published in the spring.

The economic slowdown means the Treasury is unlikely to make a commitment to a balanced budget in 2002 as had first been expected, for fear of stifling any upturn. But the country's debt level – at around 118.2 per cent of GDP in 1998 – should stay on a downward path.

The bigger question is how much the economy will grow in 1999, after the most sluggish performance in the euro-zone last year. On the positive side, some economists are expecting a pick-up in consumer consumption and business investment now that the exchange rate is fixed and interest rates are low.

The pessimists are concerned that recent trade figures show a further cutback in Italian exports to central and eastern Europe and even the US.

Adding to the fears is the growing uncertainty about the political situation in Italy, with an increasing likelihood that there will be elections in the autumn of this year or the spring of 2000.




Some economists expect consumer consumption to pick up AP

AUSTRIA by Eric Frey in Vienna

Slowdown should be short lived

Economic growth in Austria is poised to slow down this year following an excellent performance in 1998, when gross domestic product expanded by 3.3 per cent.

A sharp decline in export growth in the wake of the Asian and Latin American financial crises has already cut an industrial order backlog and given most export-oriented companies a cautious outlook for the year.

The latest downward revision by the two leading economic research institutes, Wifo and IHS, puts the 1999 growth rate at 2.4 per cent, but other economists do not expect more then 2 per cent GDP growth.

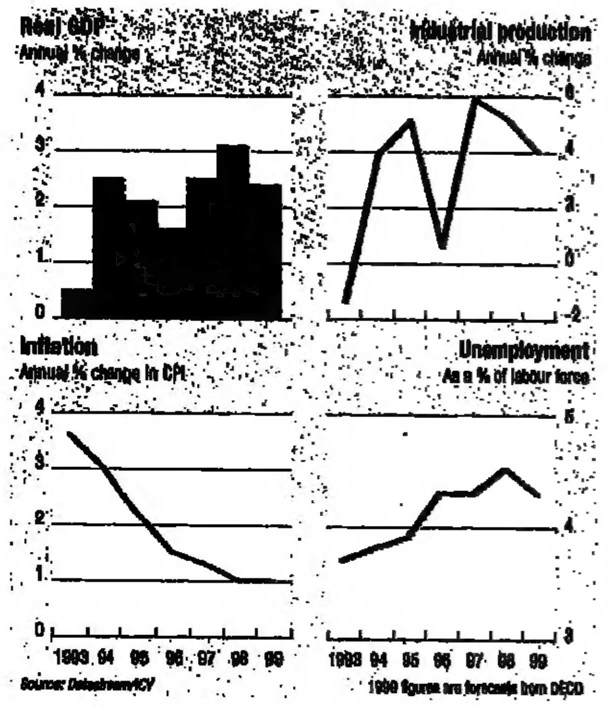
The biggest risk factor is Germany, Austria's main trading partner, where at least one leading research institute predicts a slowdown in growth to a tepid 1.4 per cent.

Still, Austria's growth rates are poised to remain above EU average in the medium term after lagging behind for most of the 1990s. And unless a US recession pulls all of Europe lower, the current slowdown should be quite short, most experts say.

Growth should again pick up in the second half of 1999 and put the country back on a growth track of around 2.4 per cent annually until the year 2003. This outcome is predicted by Wifo and IHS.

Domestic demand has proved to be surprisingly resilient while exports to other EU countries are expected to benefit from the longer-term effects of the single currency. Also, the Russian crisis has had little effect on the markets in east-central Europe, where Austrian companies are heavily engaged. In contrast, Asia and Latin America are only marginal markets for Austria.

At 4.5 per cent, Austria's unemployment rate is well below the EU average, but given the inflexibility of labour markets and long-term demographic trends, the government is unlikely to fulfil its promise and halve the jobless rate in the coming years. Inflation dropped to 0.9 per cent this year, the lowest level in decades, and interest rates have converged around the 3 per cent target set by the European Central Bank.



Source: Datastream/ICV
1999 figures are forecasts from OECD

CASE STUDY
MANDELLI

Tooled up for the single market

Of the many medium-sized manufacturers across Europe which have been struggling to assess the consequences of the new single European currency, Mandelli, a leading Italian machine tool producer, has probably devoted more thought to the issue than most.

Like many machine tool makers, Mandelli is highly international in its outlook. Of last year's sales of L115bn (about €59m) only about a third came from customers in Italy, with 40 per cent coming from from the rest of the euro-zone. North America, and European nations, such as the UK, outside the euro-zone, account for relatively large parts of the company's sales.

Mandelli has been quick to convert most of its prices into euros. Customers in each of the 11 euro-zone countries will pay the same euro price (or, for the time being, its local currency equivalent) for the same machine. Although Andrea Mattarelli, Mandelli's chief executive, expects that this year only 10 per cent of euro-zone customers will opt to pay in euros, he expects this figure will grow over time. "It will make life easier for us by simplifying our operations," he says.

Mr Mattarelli owns just over 30 per cent of the company. He took his stake, and became chief executive, just over two years ago, after previously working in the venture capital industry, electronics and shipping. The rest of the company is owned by several other private shareholders.

Mr Mattarelli's thoughts on the euro follow the broad logic that led to politicians and economists proposing it in the first place. First, Mandelli, like many other manufacturers and traders operating across Europe, should gain through not having to operate currency "hedges" to insure against the movement on foreign exchanges of the 11 national currencies in the euro-zone.

Other benefits should come through a reduction in the costs of converting different national currencies. Eventually, Mandelli should also gain through paying its suppliers mainly in euros.

Finally, Mandelli, assuming it is an efficient producer, should benefit through having a single reference price for a specific machine across the euro-zone. This is the argument related to the "price transparency" effect of the euro.

However, in the machine tool industry, two special factors interfere somewhat with the price transparency impact of the euro. First, even with such transparency, it may be difficult for customers in different parts of the euro-zone to compare, on a like-for-like basis, machines made by different manufacturers. This is because – as in many other cases of specialised machinery – machine tools normally are sold to the customer with a range of added features provided to meet specific requirements on a factory floor.

There may also be

'Mandelli should also gain through paying suppliers mainly in euros'

additional "service packages".

The second factor is the variation in payment conditions for machine tools across the continent – a subject which has concerned Mr Mattarelli as he ponders the impact of the new currency on his company. According to Mr Mattarelli, discounts on machine tools, as a proportion of list price, range across Europe from as much as 15 per cent in Italy, to perhaps half this in the UK.

These cultural traits lead to a distortion in final customer prices (important for tools costing several hundred thousand euros) that the euro will do little to ease. However, in setting a single euro price, " we will have to live with this [different national payment practices]," says Mr Mattarelli. This means customers in Italy, assuming they continue their tendency to expect large discounts, will receive machines for lower prices than those elsewhere in the euro-zone.

But Mr Matterelli shrugs off the impact. "The logic of having, as much as possible, one price list across Europe is compelling and should lead to advantages in the long run."

Peter Marsh